TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1923.

No. 262.

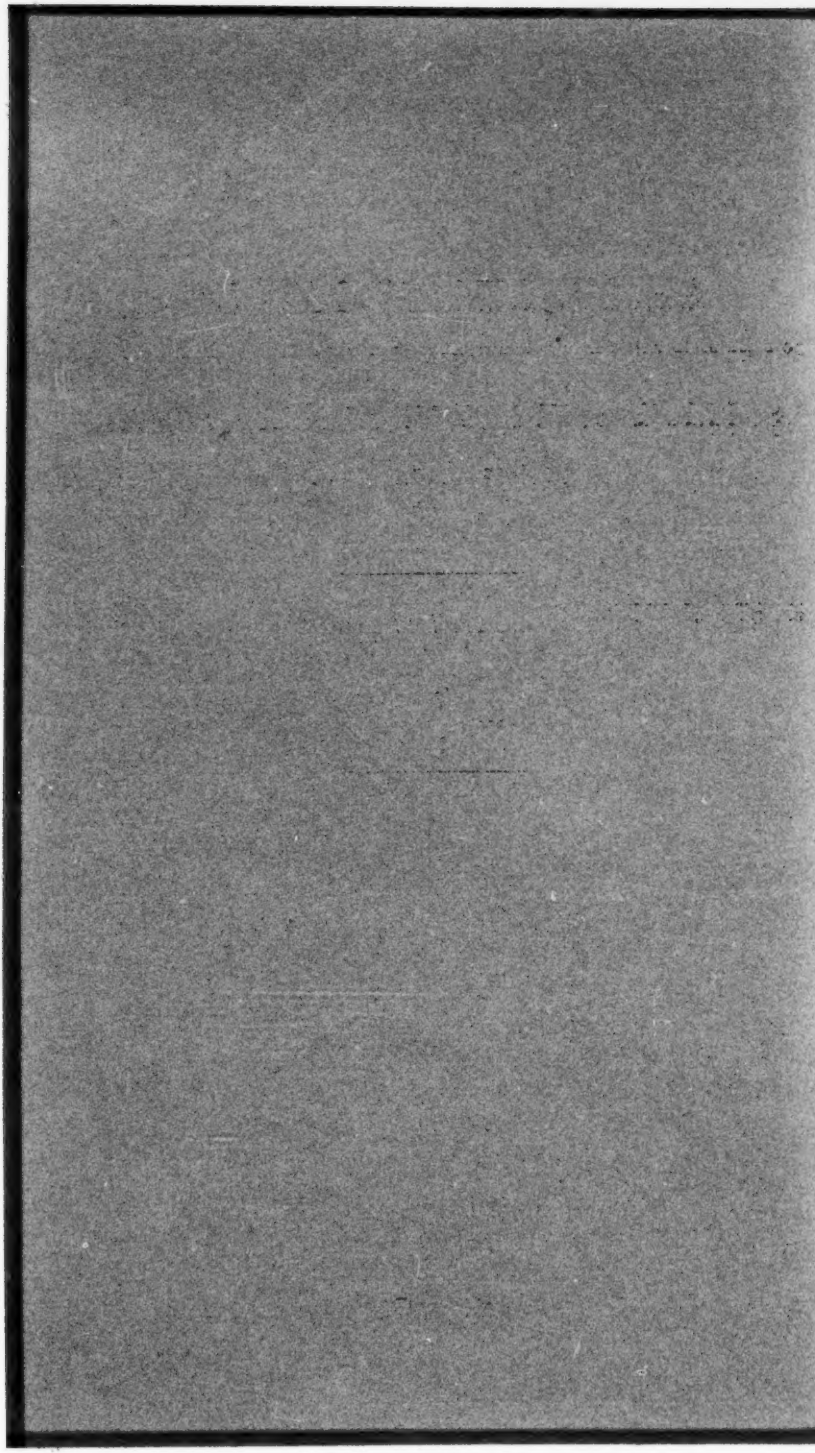
HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

LOUIS STEARN.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

PETITION FOR CERTIORARI FILED MARCH 20, 1923.
CERTIORARI AND RETURN FILED JULY 5, 1923.



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[Caption omitted.]

2 In the District Court of the United States for the Northern District of Ohio, Eastern Division.

No. 10126.

LOUIS STEARN, PLAINTIFF,

vs.

H. H. WEISS, COLLECTOR OF INTERNAL REVENUE FOR THE EIGHTEENTH DISTRICT OF OHIO, DEFENDANT.

Petition.

Filed June 13, 1919.

Plaintiff says that the defendant, H. H. Weiss, is and was at all times hereinafter mentioned the collector of internal revenue for the eighteenth district of Ohio. Plaintiff is and was at all times hereinafter mentioned a resident of Cleveland, Ohio, in said district.

For his cause of action against the defendant, plaintiff says that he was the owner during November, 1916, of one hundred five (105) shares of common stock of the par value of one hundred dollars ($100.00) each in the National Acme Manufacturing Company, an Ohio corporation; that on or about November 18th, 1916, certain holders of the common stock of said company agreed with Eastman, Dillon and Company that each share of common stock of said company which should be deposited by the owner with the depositary named in said contract should be exchanged for one hundred fifty dollars ($150.00) in cash and five (5) shares of stock of the par value of fifty dollars ($50.00) each in a new company to be organized under the laws of Ohio to be called the National Acme Company, to which company all of the assets of the National Acme Manufacturing Company were to be forthwith transferred in exchange for its entire authorized capital stock consisting of five hundred thousand (500,000) shares of the par value of fifty dollars ($50.00) each. It was further provided by the terms of said contract that one-half of said shares of the National Acme Company were to become the property of Eastman, Dillon and Company and one-half were to be dis-
3 tributed to the stockholders of the National Acme Manufacturing Company, each stockholder receiving five (5) shares of National Acme stock for each share of the National Acme Manufacturing Company stock theretofore held by him.

Plaintiff says that said contract was performed and said exchange was made pursuant to said contract, and plaintiff received for each share of stock which he theretofore owned in the National Acme Manufacturing Company, one hundred fifty dollars ($150.00) in cash and five (5) shares of stock of the par value of fifty dollars ($50.00) each in the National Acme Company.

Plaintiff says that he did not sell or dispose of any part of said National Acme stock received in exchange during 1916; that he returned for taxation as income for 1916 the profit derived from said transaction during 1916, to-wit: the difference between one hundred fifty dollars ($150.00) per share and the cost of said the National Acme Manufacturing Company stock, believing that whatever he might afterwards receive for the National Acme stock should be returned as additional profit in the year when said profit should be realized.

The Treasury Department, however, ruled in a letter to H. H. Weiss dated March 16th, 1917, "that inasmuch as a selling price or exchange value of $300.00 was placed upon each share of the National Acme Manufacturing Company's stock at the time it was sold or exchanged for five shares of stock in the National Acme Company priced or valued at $30.00 a share and $150.00 in cash, the transaction must be regarded, for Federal income tax purposes, as the sale of the stock of the National Acme Manufacturing Company," and each stockholder of the National Acme Manufacturing Company was by said ruling required to treat the sale price of each share as three hundred dollars ($300.00) and to return the difference between three hundred dollars ($300.00) and the cost price as income.

This ruling was base on the following language in the contract between stockholders and Eastman, Dillon and Company:

"First—The vendors agree to and will sell all their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said the National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at
4 and for the price of three hundred dollars ($300.00) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth."

Later provisions of the contract describe as the "securities" above referred to five shares of the common stock of the new company to be called the National Acme Company and to have the assets and capitalization hereinbefore described.

Plaintiff was compelled to make a new return, treating the transaction aforesaid as a sale of stock in the National Acme Manufacturing Company for three hundred dollars ($300.00) per share, whereby his tax under the revenue law of September 8th, 1916, was increased from one hundred one dollars and fourteen cents ($101.14) to five hundred fourteen dollars and thirty-three cents ($514.33), an increase of four hundred thirteen dollars and nineteen cents ($413.19).

Plaintiff made said return and paid said tax under protest to prevent the imposition of penalties threatened and attachment of his property.

Plaintiff says that prior to said exchange he was the owner, as a stockholder in the National Acme Manufacturing Company, of an undivided 105/50000ths interest in the assets of the National Acme

Manufacturing Company evidenced by one hundred five (105) shares of stock of said company, and that after said exchange he continued to be the owner of one-half of said interest in the same identical assets, i. e., an undivided 525/500000ths interest evidenced by five hundred twenty-five (525) shares of National Acme stock; that he received fifteen thousand seven hundred fifty dollars ($15,750) for the half interest which he parted with, but that the return which the defendant compelled him to make as aforesaid treated the transaction as a sale of his entire interest for $31,500.00.

On or about the 30th day of June, 1917, plaintiff filed with the Commissioner of Internal Revenue a claim for refund of said sum of four hundred thirteen dollars and nineteen cents ($413.19), said claim being an appeal to the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof. The decision of the Commissioner of Internal Revenue has been delayed more than six months from the date of said appeal and plaintiff alleges on information and belief that no decision on said appeal has yet been reached or announced. No part of said tax has been repaid to plaintiff. Wherefore plaintiff brings this action in this court pursuant to the statutes of the United States, to recover said internal revenue tax illegally assessed and collected, as aforesaid.

Wherefore plaintiff asks judgment against the said H. H. Weiss, collector of internal revenue for the eighteenth district of Ohio, in the sum of four hundred thirteen dollars and nineteen cents ($413.19) with interest from the 30th day of June, 1917.

THOMPSON, HINE & FLORY,
Attorneys for Plaintiff.

[Jurat showing the foregoing was duly sworn to by Louis Stearn. Omitted in printing.]

Præcipe for summons.

To the CLERK:

Please issue summons in the above-entitled case returnable according to law, endorse the same action for money.

THOMPSON, HINE & FLORY,
Attorneys for Plaintiff.

6 In United States District Court.

Answer.

Filed July 11, 1919.

Now comes E. S. Wertz, United States attorney for the Northern District of Ohio, and for answer to the above-entitled cause of action says that he is the legal representative of H. H. Weiss, collector of internal revenue for the eighteenth district of Ohio, the defendant aforesaid, in all matters officially arising under and regarding the cause of action alleged in the petition, and further answering admits

that H. H. Weiss is and was at all times named in the petition the collector of internal revenue for the eighteenth district of Ohio, and that plaintiff was at all times named in the petition a resident of Cleveland, Ohio, in said district.

Further answering the said defendant, H. H. Weiss, collector of internal revenue for the eighteenth district of Ohio, denies each and all of the allegations of the plaintiff's petition herein, adverse to the interest of the said defendant, or the United States of America.

Wherefore, defendant prays that said petition be dismissed and that he go hence without costs.

E. S. WERTZ,
United States Attorney.

7 In United States District Court.

Stipulation.

Filed April 6, 1920.

Now comes the plaintiff by his attorneys, Thompson, Hine & Flory, and also comes the defendant by his attorney, E. S. Wertz, and consents in writing to waive the trial of the above-entitled cause to a jury, and consents to submit the issues to the court on the pleadings and the agreed statement of facts without the intervention of a jury.

THOMPSON, HINE & FLORY,
Attorneys for Plaintiff.
For the U. S. Attorney,
By JOSEPH C. BREITENSTEIN,
Attorney for Defendant.

Approved:
D. C. WESTENHAVER, *Judge.*

In United States District Court.

Order approving stipulation waiving trial to jury and submitted on agreed statement of facts.

Entered April 6, 1920, by D. C. Westenhaver, judge.

Pursuant to stipulation filed herein, it is ordered that the parties waive the trial of the above-entitled cause to a jury, and submit the issues to the court on the pleadings and agreed statement of facts, without the intervention of a jury.

8 In United States District Court.

Stipulation.

STATEMENT OF AGREED FACTS.

Filed April 9, 1920.

To obviate the necessity of taking testimony as to points not in dispute and for the purpose of this cause, the parties, plaintiff and

defendant, agree to and do hereby stipulate the following facts to be true, and consent that this cause may be heard and determined on said facts, and such additional testimony as may be offered by either party.

Defendant, H. H. Weiss, is and was at all times mentioned in the petition herein, the collector of internal revenue of the United States for the eighteenth collection district of the United States, with offices in Cleveland, Ohio.

Plaintiff is and was at all times mentioned herein, a resident of Cleveland, Ohio, in said district.

Plaintiff was the owner on November 1, 1916, of one hundred and five (105) shares of common stock, of the par value of one hundred dollars ($100) each, in the National Acme Manufacturing Company, an Ohio corporation: that, on or about November 8, 1916, a contract for the disposition of all the common stock of said company, including plaintiff's, was entered into between certain of the stockholders and Eastman, Dillon & Company—a copy of which contract is hereto attached, marked "Exhibit A" and made a part thereof by reference: that said contract was performed in accordance with the terms thereof, and plaintiff received for each share of the stock which he owned in the National Acme Manufacturing Co., one hundred and fifty ($150) dollars in cash and five (5) shares of stock of the par value of fifty ($50) dollars each in the National Acme Company the new corporation organized in accordance with the terms of the agreement above referred to: that plaintiff did not sell or dispose of any part of said National Acme stock so received during 1916; and that he returned for taxation as income for 1916 the difference between one hundred and fifty ($150) dollars per share and the cost of said National Acme Manufacturing Company stock.

That the Treasury Department ruled in a letter to the said H. H. Weiss, dated March 6th, 1917:

"That inasmuch as a selling price or exchange value of
9 $300.00 was placed upon each share of the National Acme Manufacturing Company's stock at the time it was sold or exchanged for five shares of stock in the National Acme Company priced or valued at $30.00 a share and $150.00 in cash, the transaction must be regarded for Federal income tax purposes, as the sale of the stock of the National Acme Manufacturing Company."

And each stockholder of the National Acme Manufacturing Company was by said ruling required to treat the sale price of each share as three hundred dollars ($300.00) and to return the difference between three hundrd dollars ($300.00) and the cost price as income.

That this ruling was based among other things on the following language in the contract between said stockholders and Eastman, Dillon and Company:

"First—The vendors agree to and will sell all their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the

common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at and for the price of three hundred dollars ($300.00) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth."

Later provisions of the contract describe as the "securities" above referred to five shares of the common stock of the new company to be called the National Acme Company and to have the assets and capitalization hereinbefore described.

That plaintiff was compelled to make a new return, treating the transaction aforesaid as a sale of stock in The National Acme Manufacturing Company for three hundred dollars ($300.00) per share, whereby his tax under the revenue law of September 8th, 1916, was increased from one hundred one dollars and fourteen cents ($101.14) to five hundred fourteen dollars and thirty-three cents ($514.33), an increase of four hundred thirteen dollars and nineteen cents ($413.19).

That plaintiff made said return and paid said tax under protest to prevent the imposition of penalties threatened and attachment of his property; that on or about the 30th day of June, 1917, plaintiff filed with the Commissioner of Internal Revenue a claim for refund of said sum of four hundred thirteen dollars and nineteen cents ($413.19); that the decision of the Commissioner of Internal Revenue was delayed more than six months from the date of said appeal and that no part of said tax has been repaid to plaintiff.

THOMPSON, HINE & FLORY,
Attorneys for Plaintiff.
E. S. WERTZ,
U. S. Attorney, Attorney for Defendant.

EXHIBIT A IN EVIDENCE.

This agreement, made by and between W. D. B. Alexander, A. W. Henn and E. C. Henn, of Cleveland, Ohio, parties of the first part, hereinafter designated as vendors, and Messrs. Eastman, Dillon & Company, of New York, parties of the second part, hereinafter designated as purchasers, is to witness:

That whereas, the vendors, are the owners of more than fourteen thousand (14,000) shares of the common capital stock of The Nation Acme Manufacturing Company of Cleveland, Ohio, organized under the laws of the State of Ohio; and

Whereas, the purchasers desire to acquire the same and such other shares as may be deposited hereunder:

Now, therefore, it is agreed:

First—The vendors agree to and will sell all their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing

Company, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at and for the price of three hundred dollars ($300) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth; provided, however, and this contract is made upon the express condition, that it shall not become operative unless, on or before December 1st, A. D. 1916, at least eighty per centum (80%) of the entire outstanding common capital stock of said company is deposited hereunder, for sale in accordance with the terms hereof, with said depositary.

Second—Vendors have exhibited to the purchasers the financial statement of said The National Acme Manufacturing Company as of date September 30th, 1916, and have stated that the combined earnings of its so-called "Windsor plant" recently acquired
11 and its other plants, during 1916, will approximate five millions of dollars ($5,000,000), during the year 1915 were approximately two millions five hundred thousand dollars ($2,500,000), and during the three years prior thereto approximately from five hundred thousand (500,000) to eight hundred thousand (800,000) dollars per annum.

The purchasers shall, on or before December 1st, 1916, complete such examination, if any, as they desire to make of the company's books and property, to verify such statements of earnings and financial condition and the title of the company's properties, and shall, on or before December 4th, advise the vendors of the result of such examination; and if no examination is made, or unless such examination, if made, disclose that such statements are not substantially correct, or that the titles of its property are defective in some serious respect not readily to be corrected, the purchasers shall proceed to pay for the deposited stock as herein provided. Provided that if the examination made by the purchasers disclose that such statements are not substantially correct, or that the title to its property are defective in some serious respect not readily to be corrected, and the transaction fail for that reason, the depositary shall forthwith return to the purchasers any moneys theretofore deposited by them hereunder, and shall return to the depositors their stock deposited with it.

Third—The vendors will, upon the execution hereof, deliver to the Cleveland Trust Company, of Cleveland, Ohio, as depositary, certificates of all their shares of the said common capital stock, duly endorsed for transfer, and subject the same to the terms of this agreement, and will make an effort to procure the deposit by all the other stockholders of said corporation of certificates of their shares of its said common capital stock, duly endorsed in blank for transfer, with said depositary, subject to the terms of this agreement, and to constitute the vendors, or a majority of them, attorneys in fact and proxies of the depositing stockholders to vote said stock in such manner as may be necessary to carry out the purposes hereof. If and whenever, on or before December 1st, 1916, the depositary shall

notify the purchasers that there has been deposited with it at least eighty per cent (80%) of all said outstanding common capital stock, the purchasers will, within five (5) days from the date of such notice, deposit with said The Cleveland Trust Company, as such depositary, at Cleveland, Ohio, or for its account at the Chase
12 National Bank in the city of New York, as it may direct, subject to the terms of this agreement, the sum of five hundred thousand dollars ($500,000) in cash, and the further sum of seven millions of dollars ($7,000,000) within ten (10) days from the date of such notice.

Fourth—The purchasers and vendors will cause to be incorporated under the laws of the State of Ohio, a manufacturing corporation, with generally similar powers to those of said The National Acme Manufacturing Company, under the corporate name of "The National Acme Company" or such other name similar thereto as the parties hereto may desire. Said corporation so to be formed shall have an authorized capital stock of twenty-five millions of dollars ($25,000,000) of common stock, divided into five hundred thousand shares, of the par value of fifty dollars ($50.00 each. Upon the organization of said proposed corporation the purchasers and vendors will cause such proceedings to be had by its stockholders and directors as will cause it to purchase all the property and assets of every kind whatsoever of said The National Acme Manufacturing Company, including the good will of its business and subject to all its outstanding contracts and liabilities, now or hereafter accrued, which are to be assumed by said new corporation and paid as they mature, in consideration of the sum of twenty-five millions of dollars ($25,000,000), payable by its entire authorized issue of stock, and to issue such stock in payment therefor.

The purchasers and vendors will use their best endeavors to cause such proceedings to be had by the stockholders and directors of said The National Acme Manufacturing Company as will cause all said property and assets, including its good will, to be sold to the newly organized company, at the price and on the terms above set forth, and full title thereto to be vested in that company and to receive in payment therefor said capital stock of the newly organized company. The purchasers and vendors will cause all the stock of said newly organized company (except nine (9) qualifying shares of directors) to be issued to the Cleveland Trust Company, depositary, or such person as it may nominate, to be held and distributed by it as hereinafter provided.

Fifth—Said The Cleveland Trust Company, depositary, shall forthwith distribute said twenty-five millions of dollars ($25,000,000) (less qualifying shares), par value, of the common capital stock of said new company, and the said sum of seven millions five hundred thousand dollars ($7,500,000) in the following manner, to wit:
13 (a) If all the common stock of said The National Acme Manufacturing Company has been deposited with it, it will assign and transfer, or cause to be assigned and transferred to the

purchasers, or their order, one-half, or two hundred and fifty thousand (250,000) shares (excluding four qualifying shares for directors), of said capital stock of said newly organized company, and will, out of said sum of seven million five hundred thousand dollars ($7,500,000), pay to each depositing stockholder an amount equal to one hundred and fifty dollars $(150.00) upon each share deposited by him. The depositary will, however, retain, with power to vote the same, the remaining one-half, or two hundred and fifty thousand (250,000) shares (excluding five qualifying shares of said stock) until May 31st, A. D. 1917 (unless and to the extent that the purchasers may consent to earlier deliveries), at the expiration of which time it will assign and transfer, or cause to be assigned and transferred, said shares to the depositing stockholders, or their assigns, pro rata.

(b) If less than the entire amount of the common capital stock of the National Acme Manufacturing Company is deposited hereunder, the depositary shall follow a similar procedure, except that it shall retain ten (10) shares (five from each one-half above named) of the capital stock of the new company, with power in itself or its nominees to vote the same, and one hundred and fifty dollars ($150.00) in money, on account of each share of stock not so deposited, until adjustment for the purchase of such non-deposited stock, under the laws of Ohio or otherwise, can be had. The purchasers shall make whatever adjustment may be necessary to acquire such non-deposited stock, and to that end may make use of the shares of stock and money retained by the depositary under the provisions hereof, at the rate of, but not exceeding one hundred and fifty dollars ($150.00) in cash and two hundred and fifty dollars ($250.00), par value, of said new stock for each share of such old stock; and when such nondeposited stocks shall have been acquired by the purchasers, the depositary shall turn over to the purchasers any shares or money then remaining in its hands; provided, however, that the vendors, if they desire, shall have the right to participate in the purchase of such nondeposited stock to the extent and upon the terms which may be deemed equitable by Messrs. A. H. Wiggin, president of the Chase National Bank of New York, and F. H. Goff, president
14 of the Cleveland Trust Company, of Cleveland, Ohio, and provided further, that in lieu of their portion of the retained stock above provided for, the purchasers may substitute and deposit such other collateral as meets the approval of said Wiggin and Goff.

Sixth—The vendors, being the active executive officers of the National Acme Manufacturing Company in the management of its business, hereby agree to accept and retain, if elected thereto, for a period of five years from and after its organization, the same officers or positions therein that they now hold in the present company, or officers or positions involving like duties, it being the desire of both parties hereto that the present management of the business be not interfered with by its transfer to the new company.

Seventh—The purchasers and vendors will, in the organization of the new company, cause its regulations to provide for a board of directors nine (9) in number, of whom four (4) shall be nominated by them and five (5) by the vendors.

Eighth—The purchasers and vendors further agree that they will cause the new corporation to make application for and use their best efforts to have its stock listed upon New York, Boston, and Cleveland Stock Exchanges, and the vendors will cooperate with them therein.

Ninth—It is represented by the vendors that the one million five hundred thousand dollars ($1,500,000) par value, of the outstanding preferred stock of the National Acme Manufacturing Company, has already been called by said company for redemption on January 1st, 1917, at the price of one hundred and five dollars ($105.00) per share and accrued dividends thereon at the rate of six per cent (6%), and they agree that said preferred stock will be in fact retired on or before the consummation of this deal, or that the cash required for such redemption will have been deposited by said company in the Cleveland Trust Company, as provided in the certificates of said preferred issue as a separate fund for the full redemption of said issue, it being distinctly understood that all, or a portion of the sum required for such redemption will or may be borrowed by said The National Acme Manufacturing Co. for the purpose, and that its liability therefor will be a part of the indebtedness assumed by the new company in the transaction hereinbefore set forth.

Tenth—It is further agreed that during the pendency of
15 this contract provided the transaction is closed on or before January 1st, 1917, no dividends will be paid on the common stock of the present company other than its regular one per cent (1%) dividend to be declared on December 13th next.

Eleventh—It is further agreed that all the expenses of the formation of the proposed new company, including placing it in such position as to in every way carry out the portions of this agreement devolving upon it, the transfer from the old company to it of its property, the vesting in the new company of full title thereto and the dissolution of the old company, which shall be effected as soon as it legally may, shall be borne by the new company. All expenses, legal or otherwise, incurred by either of the parties hereto, on their own account and for their own benefit, shall be borne respectively by them.

Twelfth—It is further agreed that the Cleveland Trust Company, named as depositary herein, may issue receipts for stocks deposited with it, in accordance with and subject to the terms of this contract.

Thirteenth—The purchasers agree that all things to be done and performed by them will be completed on or before December 31st, 1916, so that the transaction may be closed on or before that date.

Fourteenth—If, in carrying out the terms of this contract, it is deemed desirable to make any modifications therein or additions thereto, the matter shall be submitted to said Messrs. A. H. Wiggin

and F. H. Goff, who may make any such modification or addition which they deem advisable or desirable, other than change in price of the stock sold or time of payment therefor, which they have no power to modify.

In testimony whereof, said parties have hereunto affixed their signatures, this 8th day of November, A. D. 1916.

W. D. B. ALEXANDER, (signed)
A. W. HENN, (signed)
E. C. HENN, per A. W. H., (signed)
Vendors.

EASTMAN, DILLON & COMPANY.
By HERBERT LOWELL DILLON, (signed)
Purchasers.

16 CLEVELAND, OHIO, *March 22nd, 1920.*

I hereby certify that I have examined the above contract marked "Exhibit A" and compared thes ame with the original contract dated November 8, 1916, between W. D. B. Alexander, A. W. Henn and E. C. Henn, vendors, and Eastman, Dillon & Company, purchasers, and that the above copy marked "Exhibit A" is a true copy of said original contract dated November 8, 1916.

In witness whereof, I have hereunto affixed my signature and the seal of said company, this 22nd day of March, 1920.

[SEAL.] N. S. RATHBURN.
Secretary of the National-Acme Company.

In United States District Court.

Stipulation.

AMENDED STATEMENT OF FACTS.

Filed Nov. 4, 1921.

To obviate the necessity of taking testimony as to points not in dispute, and for the purpose of this cause, the parties, plaintiff and defendant, agree to and do hereby stipulate the following facts to be true, and consent that this cause may be heard and determined on said facts, and such additional testimony as may be offered by either party.

The defendant, H. H. Weiss, was at all times mentioned in the petition herein, the collector of internal revenue of the United States for the eighteenth collection district of the United States, with offices in Cleveland, Ohio.

Plaintiff is and was at all times mentioned herein, a resident of Cleveland, Ohio, in said district.

Plaintiff was the owner on November 1st, 1916, of one hundred and five (105) shares of common stock, of the par value of one hundred dollars ($100.00) each, in the National Acme Manufacturing

17 Company, an Ohio corporation having an issued capital stock of fifty thousand (50,000) shares of common stock of one hundred dollars ($100.00) each. On or about November 8th, 1916, a contract for the disposition of all the common stock of said company, including plaintiff's, was entered into between certain of the stockholders and Eastman, Dillon & Company, a copy of which contract marked "Exhibit A" is attached to the original "statement of agreed facts" heretofore filed in this cause and said contract is made a part hereof by reference. Subsequent to November 8th, 1916, said contract was performed in accordance with the terms thereof and plaintiff received for each share of the stock which he owned in the National Acme Manufacturing Company one hundred and fifty dollars ($150.00) in cash and five (5) shares of stock of the par value of fifty dollars ($50.00) each in the National Acme Company, the new corporation organized in accordance with the terms of the contract above referred to, and the assets of the National Acme Manufacturing Company were transferred to the National Acme Company, and after such transfer the National Acme Company had the same assets and liabilities as the National Acme Manufacturing Company had theretofore had and no other. Plaintiff did not, during the year 1916, sell or dispose of any part of said National Acme stock so received. He returned for taxation as income for 1916 the difference between one hundred fifty dollars ($150.00) per share and the cost of said National Acme Manufacturing Company stock.

The Treasury Department ruled in a letter to the said H. H. Weiss, dated March 6th, 1917:

"That inasmuch as a selling price or exchange value of $300.00 was placed upon each share of the National Acme Manufacturing Company's stock at the time it was sold or exchanged for five shares of stock in the National Acme Company priced or valued at $30.00 a share and $150.00 in cash, the transaction must be regarded for Federal income tax purposes, as the sale of the stock of the National Acme Manufacturing Company."

And each stockholder of the National Acme Manufacturing Company was by said ruling required to treat the sale price of each share as three hundred dollars ($300.00) and to return the difference between three hundred dollars ($300.00) and the cost price as income.

This ruling was based among other things on the following language in the contract between said stockholders and Eastman, Dillon and Company:

18 "First—The vendors agree to and will sell all their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at and for the price of three hundred dollars ($300.00) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth."

Later provisions of the contract describe as the "securities" above referred to five shares of the common stock of the new company to

be called the National Acme Company and to have the assets and capitalization hereinbefore described.

Plaintiff was compelled to make a new return, treating the transaction aforesaid as a sale of stock in the National Acme Manufacturing Company for three hundred dollars ($300.00) per share, whereby his tax under the revenue law of September 8th, 1916, was increased. It is stipulated that if the court should find that the only taxable income realized from the disposition of each share of National Acme Manufacturing Company stock was the difference between the entire cost of each share and the cash (i. e. $150.00) received in exchange for such share, judgment should be entered in favor of plaintiff for three hundred forty-five and 67/100 dollars ($345.67), this being the amount of taxes collected by defendant from plaintiff in excess of the amount which was lawfully due if plaintiff's taxable income from the disposition of each share of National Acme Manufacturing Company stock was the difference between the entire cost of each share and the cash received in exchange therefor. If the court should find that the taxable income realized from the disposition of each share of said stock was the difference between one-half the cost of such share and the cash received therefor, judgment should, in such event, be rendered in favor of plaintiff for two hundred sixty-eight and 89/100 dollars ($268.89), such amount being the sum collected by defendant from plaintiff in excess of the amount lawfully due if the only taxable income realized from the disposition of each share of National Acme Manufacturing Company stock was the difference between one-half the cost of such share and the cash received therefor. This stipulation as to the amount for which judgment should be rendered in certain events is for the convenience of the court in order to save detailed
19 evidence as to the items of the return, without prejudice to the right of either party, prosecute error from any judgment which may be rendered.

Plaintiff made said new return and paid said tax to the defendant under protest to prevent the imposition of penalties threatened and attachment of his property. On or about the 30th day of June, 1917, plaintiff filed with the Commissioner of Internal Revenue a claim for refund of the sum of four hundred thirteen and 19/100 dollars ($413.19), the amount by which plaintiff claimed his tax had been unlawfully increased by reason of the ruling of the Treasury Department hereinbefore referred to. Said claim was an appeal to the Commissioner of Internal Revenue according to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof. The decision of the Commissioner of Internal Revenue was delayed more than six (6) months from the date of filing said appeal and no part of said tax has been repaid to plaintiff.

THOMPSON, HINE & FLORY,
Attorneys for Plaintiff.

E. S. WERTZ,
U. S. Attorney, Attorney for Defendant.

In United States District Court.

Submission of cause.

Entered November 10, 1921, by D. C. Westenhaver, Judge.

This day came the parties, by their attorneys, and a jury having been waived, this case was argued by counsel, submitted to the court on the pleadings and the evidence, and taken under advisement by the court.

20 In United States District Court.

Motion.

Filed Nov. 10, 1921.

Now comes the plaintiff and moves the court for a finding of fact finding for the plaintiff on all the issues joined, and for a finding that prior to the transactions set forth in the petition plaintiff was the owner as a stockholder in the National Acme Manufacturing Company, of an undivided 105/50000 interest in the assets of said company, evidenced by one hundred and five shares of stock of said company, and that after said exchange he continued to be the owner of one-half of said interest in the same identical assets, i. e. an undivided 525/500000 interest, evidenced by five hundred and twenty-five shares of National Acme stock, and that the only income realized by the plaintiff from the transactions set forth in the petition, and proved by the evidence, was the cash received for said National Acme Manufacturing Company stock (i. e. fifteen thousand seven hundred and fifty dollars ($15,750.00) less the cost of such stock or less one-half the cost of such stock.

All of the above findings are requested on the ground that there is no substantial evidence to sustain any other conclusion.

Plaintiff moves the court to find as a conclusion of law that plaintiff received no taxable income from the transactions set forth in the petition in excess of fifteen thousand seven hundred and fifty dollars ($15,750.00), less either the cost of said stock, or one-half the cost of said stock, and that plaintiff is entitled to judgment against the defendant in the sum of three hundred forty-five and 67/100 dollars ($345.67), or two hundred sixty-eight and 89/100 dollars ($268.89) with interest from the 30th day of June, 1917.

THOMPSON, HINE & FLORY,
Attorneys for Plaintiff.

21 In United States District Court.

Opinion.

Filed Feb. 17, 1922.

WESTENHAVER, District Judge:

This is an action brought to recover income taxes paid under protest. The parties, by stipulation in writing, have waived their right to a jury trial and have submitted the case to the court in lieu of a jury, upon an agreed statement of facts. The original agreed statement of facts filed herein April 9, 1920, as supplemented and amended by further agreement filed herein November 4, 1921, is adopted as my findings of fact and ordered to be filed as a part of the record. I have given due consideration to the questions involved, but my obligations in other directions are such that I shall do no more by way of opinion than to state briefly my conclusions. Whether or not the plaintiff is entitled to recover depends upon the correct understanding and meaning of the agreement in writing dated November 8, 1916, executed by W. D. B. Alexander, A. W. Henn and E. C. Henn, parties of the first part, and Eastman, Dillon & Company, of New York, parties of the second part. It is the Government's contention that this transaction as therein agreed and as carried out was in substance and legal effect a sale by the first parties and all of the stockholders of the National Acme Manufacturing Company of their stock in said company, to the parties of the second part, at an agreed valuation of $300 a share, of which $150 was to be paid, in cash and the residue in securities of a new and independent corporation to be organized and called the National Acme Company. This being so, the Government further contends that the profit made by each stockholder on the sale of its stock is income and that the amount of this profit is to be ascertained by adopting $300 a share as the sale price and deducting therefrom the cost to the stockholder of his stock, if bought since March 1, 1913, or the market value on March 1, 1913, if bought before that date. The plaintiff was a stockholder who participated on the basis set forth in said agreement.

All counsel agree that the substance and not the form of the transaction is controlling, and that the court will and must look through the machinery and verbiage in order to ascertain the true substance and nature of the transaction. Having done this, I am of opinion that the contention of the Government is not sound. The

22 real transaction was a sale by the stockholders of the old company to Messrs. Eastman, Dillon & Company of a one-half interest in their shares of stock and a reorganization by the old stockholders and Eastman, Dillon & Company, of the corporation, the substance and legal effect of which was to leave all stockholding interests and all the corporate assets in precisely the same situation after the transaction was fully carried out as it was when it was

begun. Exhibit A is an agreement not between the old corporation and the new corporation but between the stockholders of the old corporation and persons desirous of purchasing a one-half interest therein. The parties contemplated an increase of the capital stock from a par value of five million to a par value of twenty-five million and a reduction in the par value of each share from one hundred dollars a share to fifty dollars a share. In actual fact, this is all that was done or accomplished except the purchase by Eastman, Dillon & Company of one-half of the shares of the old company for $7,500,000. In order to accomplish this result and avoid legal difficulties, the transaction it was contemplated, when the agreement was made, was to take the form of a transfer from the old company to the new company of all the corporate assets. The new company was to have the same management and to be chartered for the same objects and purposes and under the laws of the same State. The result in substance and legal effect is the same as if the shares had merely been transferred on the books of the old company to Eastman, Dillon & Company and thereafter an amendment made and filed to the charter of the old company reducing the par value of each of its shares from one hundred dollars to fifty dollars and increasing the par value thereof from five million to twenty-five million dollars. The only reason why this course was not adopted is that probably greater difficulties would have been encountered in showing that the new stock to be issued on the basis of five for one had in fact been fully paid up.

All this appears from the terms of the agreement and the agreed statement of facts. The stockholders of the old company, it must be held, sold one-half of their shares of stock to Eastman, Dillon & Company. They received therefor the sum of $150 in cash. They had no option of taking $300 in cash or of getting anything else except an increased number of shares of reduced par value as a result of the changes in corporate form and organization. Neither the new nor the old corporation parted with any of its property as a
23 result of these transactions. The stockholders of the old company received no part of the assets of the old corporation. Nor did said corporation receive anything from the new to distribute from the old as a part of its surplus or capital for distribution among stockholders.

This being the true substance and legal effect of the agreement and of the transactions under consideration, it follows that the income derived or gained by plaintiff, and other stockholders similarly situated, from his stock in the old company, or as a result of the sale made thereof, is the cash received by him less the cost of each share to him. Upon this basis it is agreed that the income tax assessed and collected, exceeds what should have been assessed and collected, by the sum of $268.89. Judgment will be entered accordingly. An exception may be noted.

Upon the law as applied to these facts, the case falls within the principles and holdings of the following authorities: Towne vs.

Eisner, 245 U. S. 418; Southern Pacific Co. vs. Lowe, 247 U. S. 330; Gulf Oil Corpn. vs. Lewellyn, 248 U. S. 71, 72; Eisner vs. Macomber, 252 U. S. 189; Alpha Portland Cement Co. vs. United States (3 C. C. A.), Fed. 339. See also Montgomery on Income Tax Procedure, ed. 1918, pp. 95–98.

The case does not, in my opinion, fall within the principle and holdings of the authorities relied on by the Government, namely, Peabody vs. Eisner, 247 U. S. 347; Lynch vs. Hornby, 247 U. S. 339; Rockefeller vs. U. S., decided by U. S. Supreme Court November 21, 1921; United States vs. Phellis, decided by U. S. Supreme Court November 21, 1921.

The principles distinguishing these two classes of cases are definite and well understood. The difficulty, as usual, arises in applying them to the facts of a given case and determining in the light thereof by which set of principles the given case is controlled. The distinguishing characteristic, however, is that the existing corporation must have segregated and placed within the exclusive control of the stockholders some part of its corporate assets, particularly of its profits or accumulated surplus, for, if the dividend is properly to be regarded as a liquidation of capital, then it is not to be regarded as income. In the present case nothing of this kind was done. Plaintiff, and stockholders similarly situated, as already said, received purchase money for a sale of their stock from Eastman, Dillon & Company, but nothing from the corporate assets of either company. Of the cases relied on by the Government, the case
24 closest to the border line upon the facts is the Phellis case, but Mr. Justice Pitney emphasizes the characteristic thus noted as the basis of the court's decision. For instance, the old company, a New Jersey corporation, he says, "had accumulated an excess of assets over liabilities showing a surplus of accumulated profits: the precise amount is not important except that it should be stated that it was sufficient to cover the dividend distribution presently to be mentioned." Of the reorganization or merger of the corporations he says: "It was a part of the purpose and a necessary result of the plan of reorganization, as carried out, that common stock of the new company to the extent of $58,854,200 should be turned over to the old company, treated by it as assets to be distributed as against its liability to stockholders for accrued surplus, and thereupon distributed to them 'as a dividend.' The assent of the stockholders was based upon this as a part of the plan." And, concluding, he says: "It thus appears that in substance and fact, as well as in appearance, the dividend received by claimant was a gain, a profit, derived from his capital interest in the old company, not in liquidation of the capital but in distribution of accumulated profits of the company; something of exchangeable value produced by and proceeding from his investment therein, severed from it and drawn by him for his separate use. Hence it constituted individual income within the meaning of the income tax law, as clearly as was the case in Peabody vs. Eisner, 247 U. S. 347." An examination of

this case thus cited in support will make plain the ground upon which this case is to be distinguished from the Phellis case.

D. C. WESTENHAVER, *Judge.*

FEBRUARY 17, 1922.

25 In United States District Court.

Motion for a new trial.

Filed May 6, 1922.

Now comes the defendant herein and moves the court for a new trial of the above entitled cause for the following reasons, materially affecting the defendant's substantial rights:

First.

That the decision and judgment of the court is contrary to law.

Second.

That the decision and judgment of the court was given for the plaintiff herein when it should have been given for the defendant.

E. S. WERTZ,
United States Attorney,
Attorney for Defendant.

Order overruling same as of May 6, 1922, may be entered.

D. C. WESTENHAVER, *Judge.*

In United States District Court.

Order overruling motion for new trial.

Entered May 6, 1922, by D. C. Westenhaver, Judge.

This day this cause came on to be heard on the motion of defendant for a new trial and was submitted to the court, on consideration thereof the court overruled said motion, to which ruling of the court defendant, by his attorney, excepts.

It is further ordered by the court that the defendant have fifty (50) days in which to prepare, settle, and file his bill of exceptions in accord with general rule No. 38.

26 In United States District Court.

Judgment.

Entered May 6, 1922, by D. C. Westenhaver, Judge.

This cause came on to be heard upon the petition of the plaintiff, the answer of the defendant, and upon the statement of agreed facts

and the amended statement of facts heretofore agreed to by the plaintiff and defendant, and upon argument of counsel of the parties and a trial by jury having been waived by the parties; and the court, being fully advised in the premises, finds for the plaintiff and hereby awards and enters judgment for the plaintiff in the amount of three hundred and forty-six and 71/100 dollars ($346.71).

In United States District Court.

Findings of fact.

The court makes this the following findings of fact:

The defendant, H. H. Weiss, was, at all times mentioned in the petition herein, the collector of internal revenue of the United States for the eighteenth collection district of the United States, with offices in Cleveland, Ohio.

Plaintiff is, and was at all times mentioned herein, a resident of Cleveland, Ohio, in said district.

Plaintiff was the owner on November 1, 1916, of one hundred and five (105) shares of common stock, of the par value of one hundred dollars ($100) each, in the National Acme Manufacturing Company, an Ohio corporation, having an issued capital stock of fifty thousand (50,000) shares of common stock, of one hundred dollars ($100) each. On or about November 8, 1916, a contract for the disposition of all the common stock of said company, including plaintiff's, was entered into between certain of the stockholders and Eastman, Dillon & Company, a copy of which contract is as follows:

"This agreement, made by and between W. D. B. Alexander, A. W. Henn and E. C. Henn, of Cleveland, Ohio, parties of the first part, hereinafter designated as vendors, and Messrs. Eastman, Dillon & Company, of New York, parties of the second part, hereinafter designated as purchasers, is to witness, that

"Whereas, the vendors are the owners of more than fourteen thousand (14,000) shares of the common capital stock of the National Acme Manufacturing Company of Cleveland, Ohio, organized under the laws of the State of Ohio; and

27 "Whereas, the purchasers desire to acquire the same and such other shares as may be deposited hereunder:

"Now, therefore, it is agreed:

"First—The vendors agreed to and will sell all their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at and for the price of three hundred dollars ($300) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth; provided, however, and this contract is made upon the express condition, that it shall not become operative unless, on or before Decem-

ber 1, A. D. 1916, at least eighty per centum (80%) of the entire outstanding common capital stock of said company is deposited hereunder for sale, in accordance with the terms hereof, with said depositary.

"Second—Vendors have exhibited to the purchasers the financial statement of said The National Acme Manufacturing Company as of date September 30th, 1916, and have stated that the combined earnings of its so-called 'Windsor plant,' recently acquired, and its other plants, during 1916, will approximate five million of dollars ($5,000,000), during the year 1915 were approximately two millions five hundred thousand dollars ($2,500,000) and during the three years prior thereto approximately from five hundred thousand (500,000) to eight hundred thousand (800,000) dollars per annum.

"The purchasers shall, on or before December 1st, 1916, complete such examination, if any, as they desire to make of the company's books and property, to verify such statements of earnings and financial condition and the title of the company's properties, and shall, on or before December 4th, advise the vendors of the result of such examination; and, if no examination is made, or unless such examination, if made, disclose that such statements are not substantially correct, or that the titles of its property are defective in some serious respect not readily to be corrected, the purchasers shall proceed to pay for the deposited stock as herein provided. Provided that, if the examination made by the purchasers disclose that such statements are not substantially correct, or that the titles to its property are defective in some serious respect not readily to be corrected, and the transaction fails for that reason, the depositary shall forthwith return to the purchasers any moneys theretofore deposited by them hereunder, and shall return to the depositors their stock deposited with it.

"Third—The vendors will, upon the execution hereof, deliver to the Cleveland Trust Company, of Cleveland, Ohio, as depositary, certificates of all their shares of the said common capital stock, duly endorsed for transfer, and subject the same to the terms of this agreement, and will make an effort to procure the deposit by all the other stockholders of said corporation of certificates of their shares of its said common capital stock, duly endorsed in blank for transfer, with said depositary, subject to the terms of this agreement, and to constitute the vendors, or a majority of them, attorneys in fact and proxies of the depositing stockholders to vote said stock in such manner as may be necessary to carry out the purposes hereof. If and whenever, on or before December 1st, 1916, the depositary shall notify the purchasers that there has been deposited with it at least eighty per cent (80%) of all said outstanding common capital stock, the purchasers will, within five (5) days from the date of such notice, deposit with said The Cleveland Trust Company, as such depositary, at Cleveland, Ohio, or for its account at the Chase National Bank in the city of New York, as it may direct, subject to

the terms of this agreement, the sum of five hundred thousand dollars ($500,000) in cash and the further sum of seven millions of dollars ($7,000,000) within ten (10) days from the date of such notice.

"Fourth—The purchasers and vendors will cause to be incorporated under the laws of the State of Ohio a manufacturing corporation, with generally, similar powers to those of said The National Acme Manufacturing Company, under the corporate name of the National Acme Company, or such other name similar thereto as the parties hereto may desire. Said corporation so to be formed shall have an authorized capital stock of twenty-five millions of dollars ($25,000,000) of common stock, divided into five hundred thousand shares, of the par value of fifty dollars ($50.00) each. Upon the organization of said proposed corporation the purchasers and vendors will cause such proceedings to be had by its stockholders and directors as will cause it to purchase all the property and assets, of every kind whatsoever, of said The National Acme Manufacturing Company, including the good will of its business, and subject to all its outstanding contracts and liabilities now or hereafter
29 accrued, which are to be assumed by said new corporation and paid as they may mature, in consideration of the sum of twenty-five millions of dollars ($25,000,000), payable by its entire authorized issue of stock, and to issue such stock in payment therefor.

"The purchasers and vendors will use their best endeavors to cause such proceedings to be had by the stockholders and directors of said The National Acme Manufacturing Company as will cause all said property and assets, including its good will, to be sold to the newly organized company, at the price and on the terms above set forth, and full title thereto to be vested in that company, and to receive in payment therefor said capital stock of the newly organized company. The purchasers and vendors will cause all the stock of said newly organized company (except nine (9) qualifying shares of directors) to be issued to the Cleveland Trust Company, depositary, or such person as it may nominate, to be held and distributed by it as hereinafter provided.

"Fifth—Said The Cleveland Trust Company, depositary, shall forthwith distribute said twenty-five millions of dollars ($25,000,000) (less qualifying shares), par value, of the common capital stock of said new company and the said sum of seven millions five hundred thousand dollars ($7,500,000), in the following manner, to wit:

"(a) If all the common stock of said The National Acme Manufacturing Company has been deposited with it, it will assign and transfer, or cause to be assigned and transferred, to the purchasers, or their order, one-half, or two hundred and fifty thousand (250,000) shares (excluding four qualifying shares for directors), of said capital stock of said newly organized company, and will, out of said sum of seven million five hundred thousand dollars ($7,500,000), pay to each depositing stockholder an amount equal to one hundred

and fifty dollars ($150) upon each share deposited by him. The depositary will, however, retain power to vote the same, the remaining one-half, or two hundred and fifty thousand (250,000) shares (excluding five qualifying shares of said stock) until May 31st, A. D. 1917 (unless and to the extent that the purchasers may consent to earlier deliveries), at the expiration of which time it will assign and transfer, or cause to be assigned and transferred, said shares to the depositing stockholders, or their assigns, pro rata.

"(b) If less than the entire amount of the common capital
30 stock of The National Acme Manufacturing Company is deposited hereunder, the depositary shall follow a similar procedure, except that it shall retain ten (10) shares (five from each one half above named) of the capital stock of the new company, with power in itself, or its nominees, to vote the same, and one hundred and fifty dollars ($150.00) in money, on account of each share of stock not so deposited, until adjustment for the purchase of such nondeposited stock, under the laws of Ohio, or otherwise, can be had. The purchasers shall make whatever adjustment may be necessary to acquire such nondeposited stock, and to that end may make use of the shares of stock and money retained by the depositary under the provisions hereof, at the rate of, but not exceeding one hundred and fifty dollars ($150) in cash and two hundred and fifty dollars ($250) par value of said new stock for each share of such old stock; and when such nondeposited stocks shall have been acquired by the purchasers the depositary shall turn over to the purchasers any shares or money then remaining in its hands; provided, however, that the vendors, if they desire, shall have the right to participate in the purchase of such nondeposited stock to the extent and upon the terms which may be deemed equitable by Messrs. A. H. Wiggin, president of the Chase National Bank of New York, and F. H. Goff, president of The Cleveland Trust Company, of Cleveland, Ohio; and provided further, that in lieu of their portion of the retained stock above provided for, the purchasers may substitute and deposit such other collateral as meets the approval of said Wiggin and Goff.

"Sixth—The vendors, being the active executive officers of The National Acme Manufacturing Company, in the management of its business, hereby agree to accept and retain, if elected thereto, for a period of five years from and after its organization, the same officers or positions therein that they now hold in the present company, or officers or positions involving like duties, it being the desire of both parties hereto that the present management of the business be not interfered with by its transfer to the new company.

"Seventh—The purchasers and vendors will, in the organization of the new company, cause its regulations to provide for a board of directors, nine (9) in number, of whom four (4) shall be nominated by them and five (5) by the vendors.

"Eighth—The purchasers and vendors further agree that
31 they will cause the new corporation to make application for

and use their best efforts to have its stock listed upon New York, Boston, and Cleveland Stock Exchanges, and the vendors will cooperate with them therein.

"Ninth—It is represented by the vendors that the one million five hundred thousand dollars ($1,500,000) par value of the outstanding preferred stock of the National Acme Manufacturing Company has already been called by said company for redemption on January 1st, 1917, at the price of one hundred and five dollars ($105) per share, and accrued dicidends thereon at the rate of six per cent (6%), and they agree that said preferred stock will be in fact retired on or before the consummation of this deal, or that the cash required for such redemption will have been deposited by said company in the Cleveland Trust Company, as provided in the certificates of said preferred issue, as separate fund for the full redemption of said issue, it being distinctly understood that all, or a portion, of the sum required for such redemption will or may be borrowed by said The National Acme Manufacturing Company for the purpose, and that its liability therefor will be a part of the indebtedness assumed by the new company in the transaction hereinbefore set forth.

"Tenth—It is further agreed that during the pendency of this contract, provided the transaction is closed on or before January 1st, 1917, no dividends will be paid on the common stock of the present company, other than its regular one per cent (1%) dividend to be declared on December 13th next.

"Eleventh—It is further agreed that all the expenses of the formation of the proposed new company, including placing it in such position as to in every way carry out the portions of this agreement devolving upon it, the transfer from the old company to it of its property, the vesting in the new company of full title thereto and the dissolution of the old company, which shall be effected as soon as it legally may, shall be borne by the new company. All expenses, legal or otherwise, incurred by either of the parties hereto, on their own account and for their own benefit, shall be borne, respectively, by them.

"Twelfth—It is further agreed that the Cleveland Trust Company, named as depositary herein, may issue receipts for stocks deposited with it, in accordance with any subject to the terms of this contract.

"Thirteenth—The purchasers agree that all things to be
32 done and performed by them will be completed on or before December 1st, 1916, so that the transaction may be closed on or before that date.

"Fourteenth—If, in carrying out the terms of this contract, it is deemed desirable to make any modifications therein or additions thereto, the matter shall be submitted to said Messrs. A. H. Wiggin and F. H. Goff, who may make any such modification or addition which they deem advisable or desirable, other than change in price

of the stock sold or time of payment therefor, which they have no power to modify.

"In testimony whereof, said parties have hereunto affiixed their signatures, this 8th day of November, A. D. 1916.

"W. D. B. ALEXANDER, (signed)
"A. W. HENN, (signed)
"E. C. HENN, per A. W. H., (signed)
Vendors.

"EASTMAN, DILLON & COMPANY,
"By HERBERT LOWELL DILLON, (signed)
Purchasers."

Subsequent to November 8, 1916, said contract was performed in accordance with the terms thereof and plaintiff received for each share of the stock which he owned in the National Acme Manufacturing Company one hundred fifty dollars ($150) in cash and five (5) shares of stock, of the par value of fifty dollars ($50) each, in the National Acme Company, the new corporation organized under the laws of the State of Ohio, with the same objects and purposes as those of the old company, all of which was done in accordance with the terms of the contract above referred to, and the assets of the National Acme Manufacturing Company were transferred to the National Acme Company, and after such transfer the National Acme Company had the same assets and liabilities as the National Acme Manufacturing Company had theretofore had and no other. Plaintiff did not during the year 1916 sell or dispose of any part of said The National Acme Company stock so received. He returned for taxation as income for 1916 the difference between one hundred fifty dollars ($150.00) per share and the cost of said The National Acme Manufacturing Company stock.

The Treasury Department ruled in a letter to the said H. H. Weiss, dated March 6, 1917:

"That inasmuch as a selling price or exchange value of
33 $300.00 was placed upon each share of the National Acme Manufacturing Company's stock at the time it was sold or exchanged for five shares of stock in the National Acme Company, priced or valued at $30.00 a share, and $150.00 in cash, the transaction must be regarded, for Federal income tax purposes, as the sale of the stock of the National Acme Manufacturing Company."

And each stockholder of the National Acme Manufacturing Company was by said ruling required to treat the sale price of each share as three hundred dollars ($300.00) and to return the difference between three hundred dollars ($300.00) and the cost price as income.

This ruling was based, among other things, on the following language in the contract between said stockholders and Eastman, Dillon & Company:

"First—Vendors agree to and will sell all their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Com-

pany, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at and for the price of three hundred dollars ($300.00) per share, payable one-half in cash and one-half in securities, as hereinafter set forth."

Later provisions of the contract described as the "securities" above referred to five shares of the common stock of the new company, to be called the National Acme Company, and to have the assets and capitalization hereinbefore described.

Plaintiff was compelled to make a new return, treating the transaction aforesaid as a sale of stock in the National Acme Manufacturing Company for three hundred dollars ($300.00) per share, whereby his tax under the revenue act of September 8, 1916, was increased to $514.33, which amount was paid by plaintiff on June 11, 1917. If the only taxable income realized from the disposition of each share of the National Acme Manufacturing Company stock was the difference between the entire cost of each share and the cash (namely $150.00 per share) received in exchange for such share, the amount of the overpayment of taxes was $345.67. If the taxable income realized from the disposition of each share of said stock was the difference between one-half of the cost of such share and the cash received therefor, the amount of taxes overpaid by plaintiff in such case was $268.89.

The court further finds that the plaintiff made said new return
34 and paid said tax to the defendant under protest to prevent the imposition of penalties threatened and attachment of his property. On or about the 30th day of June, 1917, plaintiff filed with the Commissioner of Internal Revenue a claim for refund of the sum of four hundred thirteen and 19/100 dollars ($413.19), the amount by which plaintiff claimed his tax had been unlawfully increased by reason of the ruling of the Treasury Department hereinbefore referred to. Said claim was an appeal to the Commissioner of Internal Revenue according to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof. The decision of the Commissioner of Internal Revenue was delayed more than six (6) months from the date of filing said appeal and no part of said tax has been repaid to plaintiff.

In United States District Court.

Findings of law.

The court finds as a conclusion of law that the plaintiff, as a stockholder of said The National Acme Manufacturing Company, by virtue of the aforesaid transaction, in legal effect, sold one-half of his shares of stock in said The National Acme Manufacturing Company to Eastman, Dillon & Company, and that the only income derived or gained by plaintiff from his stock in said The National Acme Manufacturing Company as a result of the sale made thereof was the cash received by him, less the cost to him of the stock so sold, that is, less the cost of one-half of the stock owned by him prior to said reorganization. Upon this basis the court finds that the income tax assessed and collected exceeds what should have been assessed and collected, by the sum of two hundred sixty-eight and 89/100 dollars

($268.89). The court further finds that the plaintiff is entitled to recover interest upon this amount so overpaid from the date of overpayment to the first day of this term of court, at the rate of six per cent (6%) per annum, said interest amounting to seventy-seven and 82/100 dollars ($77.82), so that the total amount for which plaintiff should recover judgment is three hundred forty-six and 71/100 dollars ($346.71).

It is further ordered that a certificate issue to said defendant, Harry H. Weiss, of probable cause for the collection of the amount exacted.

To all of which finds of law and fact both parties except.

35 In United States District Court.

Petition for writ of error.

Filed May 13, 1922.

Now comes Harry H. Weiss, defendant herein, and says that on or about the 6th day of May, A. D. 1922, this court entered judgment herein in favor of plaintiff and against this defendant in which judgment and the proceedings had prior thereto in this cause certain errors were committed to the prejudice of this defendant, all of which will appear more in detail from the assignment of errors which is filed with this petition.

Wherefore this defendant prays that a writ of error may issue in this behalf out of the United States Circuit Court of Appeals for the Sixth Judicial Circuit for the correction of errors so complained of and that a transcript of the record, proceedings, and papers in this cause, duly authenticated, may be sent to the said Circuit Court of Appeals.

EDWIN S. WERTZ,
U. S. Attorney,
BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

36 In United States District Court.

Assignment of errors.

Filed May 13, 1922.

Harry H. Weiss, defendant in this action in connection with his petition for a writ of error, makes the following assignment of errors which he avers occurred upon the trial of the cause, that is to say:

First.

The court erred in rendering judgment for the plaintiff and against this defendant when judgment ought to have been in favor of this defendant and against the plaintiff.

Second.

The court erred in finding, as a conclusion of law, that the plaintiff as a stockholder of the National Acme Manufacturing Company in legal effect sold one-half of his shares of stock in said The National Acme Manufacturing Company to Eastman, Dillon & Company, and that the only income derived or gained by the plaintiff from his stock in said The National Acme Manufacturing Company, as a result of the sale made thereof, was the cash received by him, less the cost to him of the stock so sold, that is, less the cost of one-half of the stock owned by him prior to said reorganization.

Third.

The court erred in finding that the income tax assessed and collected from the plaintiff by this defendant exceeded what should have been assessed and collected by the sum of two hundred sixty-eight dollars ($268.89) and eighty-nine cents.

Fourth.

The court erred in finding that the plaintiff was entitled to recover interest upon the amount so found to have been overpaid.

Fifth.

The court erred in overruling defendant's motion for a new trial in this cause.

Wherefore this defendant prays that the judgment may be reversed.

EDWIN S. WERTZ,
U. S. Attorney,
BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

37 In United States District Court.

Order allowing writ of error.

Entered May 13, 1922, by D. C. Westenhaver, Judge.

On this 13th day of May, A. D. 1922, the above-named defendant, appearing by Edwin S. Wertz, United States attorney for the northern district of Ohio, and filing herein and presenting to the court his petition praying for the allowance of a writ of error and assignments of error intended to be urged by him, and praying also that a transcript of the record and proceedings and papers upon which the judgment herein was rendered, duly authenticated, be sent to the United States Circuit Court of Appeals for the Sixth Judicial

Circuit, and that such other and further proceedings may be had as may be proper in the premises.

Now on consideration thereof, the court does allow the writ of error as prayed in the petition of the defendant, without bond of the defendant, it appearing that the above entitled cause is one in which the United States, and not the record defendant, is the real party in interest, and this appeal is being taken by direction of the Department of Justice of the United States of America.

38 *Writ of error.*

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,
Sixth Judicial Circuit, ss:

The President of the United States, to the honorable the Judge of the District Court of the United States for the Northern District of Ohio, greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, or some of you, between Louis Stearn, plaintiff, and Harry H. Weiss, collector of internal revenue for the eighteenth district of the State of Ohio, defendant, a manifest error hath happened, to the great damage of the said Harry H. Weiss, collector of internal revenue for the eighteenth district of the State of Ohio, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if the judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ, so that you have the same at Cincinnati, in said circuit, on the* 11th day of June next, in the said Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States should be done.

Witness the honorable William Howard Taft, Chief Justice of the United States, the 12th day of May, in the year of our Lord one thousand nine hundred and twenty-two, and of the independence of the United States of America the one hundred and forty-sixth.

B. C. MILLER,
Clerk of the District Court of the United States for the Northern District of Ohio.
By M. E. BAUMAN,
Deputy Clerk.

(Seal.)

39 Allowed by D. C. Westenhaver, judge of the District Court.

*Not exceeding 30 days from the day of signing the citation.

[Blank return on writ of error form omitted in printing.]

40 [Citation in usual form showing service on Thompson, Hine & Flory omitted in printing.]

41 In United States District Court.

Stipulation re transcript of record.

Filed May 18, 1922.

In accordance with section 7 of rule 44 of the general rules of this court, it is hereby agreed that the record as presented to the clerk by the printer, may be certified by the clerk as required by law and the rules of the Appellate Court, as a true, full and complete copy of the original pleadings, papers, and orders used on the trial of this cause, as set forth in the precipe for transcript, without further comparison by the clerk.

THOMPSON, HINE & FLORY,
Attorneys for Plaintiff.
E. S. WERTZ,
U. S. Attorney,
BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

In United States District Court.

Certificate of probable cause.

Filed May 22, 1922.

Under the provisions of section 989, Revised Statutes of the United States, it is hereby certified that probable cause existed for the collection by Harry H. Weiss, as collector of internal revenue for the eighteenth collection district of the United States, located in Cleveland, Ohio, of the income tax in question in the above-entitled cause from the plaintiff herein, and that in so collecting said income tax, said Harry H. Weiss acted under and by direction of the Commissioner of Internal Revenue of the United States.

D. C. WESTENHAVER, *Judge.*

42 In United States District Court.

Precipe for transcript.

Filed May 26, 1922.

To the CLERK:

Please prepare transcript of record for the Circuit Court of Appeals in the above-entitled cause, and include therein the following papers and orders:

Petition and precipe filed.
Answer filed.
Stipulation and order approving stipulation waiving trial to jury and submitted on agreed statement of facts filed and entered.
Stipulation, statement of agreed facts, filed.
Stipulation as to amended statement of facts filed.
Trial in progress, jury waived, final hearing to court taken under advisement ent.
Motion by plaintiff for a finding of fact filed.
Memorandum opinion of court filed.
Motion for new trial (copy furnished).
Order of findings of fact, etc., exceptions both sides noted, filed and ent.
Petition for writ of error filed.
Assignment of error filed.
Order allowing writ of error filed and entered.
Writ of error issued.
Citation issued.
Stipulation as to printing record filed.
Certificate of probably cause filed.
And deliver all papers to the Toledo Legal Printing Company for printing.

EDWIN S. WERTZ,
U. S. Attorney,
and BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

43 In United States District Court.

Order to extend time.

Filed June 10, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to July 11, 1922.

Enter.

_____,
U. S. District Judge.

In United States District Court.

Order to extend time.

Filed July 10, 1922.

On application of defendant and for good cause shown it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to August 10, 1922.

Enter.

_____,
U. S. District Judge.

44 In United States District Court.

Certificate of clerk.

NORTHERN DISTRICT OF OHIO, *ss:*

I, B. C. Miller, clerk of the District Court of the United States for said district, do hereby certify that the annexed and foregoing pages contain a full, true, and complete copy of the final record, including the petition for a writ of error, assignment of errors and all proceedings in said cause, in accordance with the praecipe for transcript filed by plaintiff in error, the originals of which are now in my custody as clerk of said court.

There is also annexed to and transmitted with such transcript of record the writ of error and the citation issued and allowed in this case.

In testimony whereof, I have hereunto signed my name and affixed the seal of said court, at Cleveland, in said district, this 28th day of July, A. D. 1922, and in the 146th year of the independence of the United States of America.

B. C. MILLER, *Clerk.*

[SEAL.] By M. E. BAUMAN, *Deputy Clerk.*

45 PROCEEDINGS IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Cause argued in part December 6, 1922.

Before DENISON and DONAHUE, Circuit Judges, and PECK, District Judge.

These causes are argued together by Mr. Berkeley W. Henderson, assistant United States attorney, and are continued until to-morrow for further argument.

Further argued and submitted Dec. 7, 1922.

These causes are further argued by Mr. Berkeley W. Henderson, assistant United States attorney, and by Mr. C. M. Charest, special

attorney, Bureau of Internal Revenue, on behalf of the plaintiff in error, and by Mr. John G. White on his own behalf and by Mr. Charles P. Hine on behalf of Louis Stearn and are submitted to the court.

46 United States Circuit Court of Appeals for the Sixth Circuit.

Judgment.

Filed Jan. 9, 1923.

Error to the District Court of the United States for the Northern District of Ohio. This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Ohio, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court, that the judgment of the said District Court in this cause be and the same is hereby affirmed.

47 [File endorsement omitted.]

Nos. 3759 and 3790.

United States Circuit Court of Appeals, Sixth Circuit.

HARRY H. WEISS, COLLECTOR OF INTERNAL Revenue for the Eighteenth District of the State of Ohio, plaintiff in error. vs. LOUIS STEARN, DEFENDANT IN ERROR. HARRY H. WEISS, COLLECTOR OF INTERNAL Revenue for the Eighteenth District of the State of Ohio, plaintiff in error, vs. JOHN G. WHITE, DEFENDANT IN ERROR.	Error to the United States District Court for the Northern District of Ohio, Eastern Division.

Opinion.

Filed January 9, 1923.

Submitted December 7, 1922; decided January 9, 1923.

Before DONAHUE and DENISON, Circuit Judges, and PECK, District Judge.

PECK, District Judge: The question involved in these cases is whether the defendants in error were, by the District Court, properly regarded, for the purposes of income taxation under the revenue law of 1916 (39 Stats. 757) as having disposed with profit of only one-half of their respective stock holdings in the National Acme

Manufacturing Company, or whether they should have been considered as having so disposed of the entirety.

The transaction in question was had pursuant to a contract between the stockholders and Eastman, Dillon & Company, by the first paragraph of which the former apparently agreed to sell, and the latter to buy, the stock "at and for the price of three hun-
48 dred dollars ($300) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth." But the real transaction specifically required by the subsequent provisions of the contract and actually consummated was as follows:

The stockholders delivered all of their stock to an intermediary, the Cleveland Trust Company, in trust. For each share so deposited they were to, and later did, receive $150 cash and five shares of new stock of the nominal par value of $50 each, but actually valued at $30 per share for the purposes of the bargain, being, in the aggregate, one-half (250,000 shares) of the stock of a new corporation formed to take over the business. Eastman, Dillon & Company, in order to acquire the other half of the stock of the new corporation, paid to the trustee $7,500,000, being at the rate of $30 per share for 250,000 shares. The vendors and vendees then proceeded to organize the new corporation under the laws of the same State, Ohio, with the same powers and the same name, except for the dropping of the word "Manufacturing." Its capital stock, $25,000,000, was five times that of the old concern, and was divided into shares of the denomination of fifty, instead of one hundred, dollars each, as theretofore. Accordingly there were ten $50 shares of the new for each $100 share of the old stock. The new corporation issued all of its stock to the trustee in exchange for all the assets subject to the liabilities of the old company. The trustee delivered one-half (250,000) of the shares of the new stock to Eastman, Dillon & Company, in consideration of the $7,500,000 paid in, and distributed pro rata among the old stockholders, the other half, 250,000 shares, and the $7,500,000 at the agreed rate of $150 and five shares of the new for each share of the old stock. The old company was then dissolved and the new corporation continued business under the same management.

The net results, putting to one side for the moment the matter of reincorporation, were that the capital stock of the concern was increased fivefold, the face value of the shares cut in half, and that the old stockholders sold Eastman, Dillon & Company one-half of their respective holdings at the price of $30 per share for the new stock. The income tax on such profit as was made on that half which was so sold was paid by defendants in error, who were among the old stockholders. They were, however, further compelled
49 to pay a like tax because of the receipt of the other half of the new stock in exchange for the old, the Government claiming that they made the same gain thereby as upon the half which they had sold, and for the recovery of this they sued and had judgment below.

It is clear that the half in question was not sold to Eastman, Dillon & Company. This is true despite the above-quoted language of the first paragraph of the agreement, as substance must dominate form; and what was done, rather than what was agreed to be done, is the final criterion. United States v. Phellis, 257 U. S. at page 172. As to this half, the legal title never went to Eastman, Dillon & Company, nor beyond the Cleveland Trust Company, which held it for the benefit of the old stockholders, in whom the equity continued until the agreed equivalent in new stock was delivered to them and the old stock retired by the dissolution of the old corporation. Therefore, if the transaction as to this half resulted in taxable gain at all, it was not as the consequence of any sale to Eastman, Dillon & Company, but must be looked for in the transaction had between the old stockholders, the trustee, and the corporation.

The old corporation went through the form of an exchange of its assets for the new stock and a distribution thereof among its shareholders as upon final dissolution. There was nothing that can be properly called a sale of the half of the stock under consideration in any aspect of the case. The question to be decided resolves itself, therefore, to this: Is there taxable income to the stockholder in the receipt of shares of greater face value and actually worth more than the cost to him of old shares for which they are exchanged upon the occasion of a reorganization accomplished by the taking down of an old corporate structure and the setting up in its place of a new one with the same powers under the laws of the same State, but having greater capital stock, with a taking over of assets subject to liabilities and a continuance of the business under the same management and name?

It is the present policy of Congress, as shown by the statute now in force, to regard such a transaction as nontaxable (revenue act of 1921, ch. 136, p. 230, sec. 202 [c] [2]), although under the act of 1918 the matter had been made dependent upon the comparative face values of the old and new securities (40 Stats. 1060, sec. 202 [b]). The law of 1916, however, under which this case arises, did not deal expressly with exchanges of stock upon corporate reorganizations, and the case is left to be determined upon the
50 general definition of that which is taxable as "including gains, profits, and income derived from * * * business, trade, commerce, or sales or dealings in property, whether real or personal * * * also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever." (Section 2 [a].)

Except for change of corporate entity there was here a continuance of the same concern. The assets were the same, and the stockholders (assuming the sale of the other half to have been consummated) were the same, and in the same proportions; the domicile, the powers, the name, substantially, and the corporate obligations were all left as before. The same ends might have been achieved

by an amendment of the articles of incorporation providing for the increase of the capital stock, the reduction of the face value of its shares, and the change of name. Had this method of accomplishing the identical result been pursued, the increase in face value of the new certificates issued to the holders in exchange for the old would have been plainly a mere stock dividend, nontaxable under Eisner v. Macomber, 252 U. S. 189. Therefore, if the transaction be taxable it must be because of the giving up of the old and the taking on of the new charter. It is true that a new corporate being has intervened, but where a corporate entity has been found to be a mere matter of form, it has been disregarded in similar transactions in respect to income taxation. Southern Pacific Co. v. Lowe, 247 U. S. 330; Gulf Oil Co. v. Llewellyn, 248 U. S. 71; Alpha Portland Cement Co. v. United States, 261 Fed. 339; although it is not so when it is a matter of substance. Eisner v. Macomber and United States v. Phellis, supra. The latter case, strongly relied upon by plaintiff in error, does not present a parallel situation. There the surplus had been separated from the capital for the purpose of distributing it among the stockholders in the form of the stock of a new corporation to which the assets were conveyed. But the old corporation continued to exist, its stock remained outstanding, and the segregation of capital from surplus was accomplished by setting over to it assets equal to its capital stock and capabale of returning future dividends to its stockholders. In that state of affairs the Supreme Court said of the stockholder: " * * * he could sell his entire portion or any of it " (i. e. his dividend) " without parting with his
51 capital interest in the parent company, or affecting his proportionate relation to the interests of other stockholders. Whether he sold the new stock for money or retained it in preference, in either case when he received it he received as his separate property a part of the accumulated profits of the old company in which previously he had only a potential and contingent interest." Rockefeller v. United States, 257 U. S. 176, likewise involved a distribution of the stock of a corporation created to take over part of the surplus of the parent corporation while the existence of the latter continued. Peabody v. Eisner, 247 U. S. 347, exhibited the case of a distribution, as a dividend, of the stock of another corporation held by the parent company. In each of those cases there was a segregation of accumulated surplus and a distribution of it in the stock of a corporation other than the parent company, both corporations continuing to exist.

In the present case there has been no attempt on the part of the concern to segregate or distribute its surplus, but merely a reorganization accompanied by a stock dividend. It has not been divided into two corporations, one to hold the capital, the other to take the earnings, as in the cited cases. The old charter was surrendered when the new one was taken. The venture of the stockholder in the hazard of the business continues undivided. He has not drawn out his profit. His investment is still entirely in the same

enterprise, albeit represented by new certificates, yet essentially the same. For these reasons it is concluded that the distribution upon reorganization of the new stock in exchange for the old did not involve taxable income. Accordingly the judgment of the District Court is affirmed.

52 United States Circuit Court of Appeals for the Sixth Circuit.

Clerk's certificate.

I, Arthur B. Mussman, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the foregoing is a true and correct copy of the record and proceedings in the case of Harry H. Weiss, Collector, etc., vs. Louis Stearn, No. 3759, as the same remains upon the files and records of said United States Circuit Court of Appeals for the Sixth Circuit, and of the whole thereof.

In testimony whereof, I have hereunto subscribed my name, and affixed the seal of said court, at the city of Cincinnati, Ohio, this 20th day of March, A. D. 1923.

[SEAL.] ARTHUR B. MUSSMAN,
Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

53 Writ of certiorari and return.

Filed July 5, 1923.

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America, to the Honorable the Judges of the United States Circuit Court of Appeals for the Sixth Circuit, greeting:

Being informed that there is now pending before you a suit in which Harry H. Weiss, collector of internal revenue for the eighteenth district of the State of Ohio, is plaintiff in error, and Louis Stearn is defendant in error, No. 3759, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the Northern District of Ohio, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Su-

54 preme Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the honorable William H. Taft, Chief Justice of the United States, the twenty-third day of June, in the year of our Lord one thousand nine hundred and twenty-three.

[SEAL.] WM. R. STANSBURY,
Clerk of the Supreme Court of the United States.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, *ss:*

I, Arthur B. Mussman, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the transcript of the record of the proceedings of this court in the within entitled case heretofore certified by me for filing in the Supreme Court of the United States was correct and complete as the same then appeared in this court.

In pursuance of the command of the foregoing writ of certiorari I now hereby certify that on the 3rd day of July, A. D., 1923, there was filed in my office a stipulation in the above-entitled case in the following words, to wit:

In the Supreme Court of the United States, October Term, 1922.

[Title omitted.]

Stipulation as to return to writ of certiorari

It is hereby stipulated by counsel for the parties to the above-entitled cause that the certified copy of the transcript of the record now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Sixth Circuit to the writ of certiorari granted therein.

WM. J. HUGHES,
For the Solicitor General.
THOMPSON, HINE & FLORY,
Cousel for Respondent.

JUNE 29, 1923.

I further certify that the above is a true and correct copy of said stipulation and of the whole thereof. Witness my official signature and the seal of said Circuit Court of Appeals at the city of Cincinnati, in said circuit this 3rd day of July, A. D. 1923.

[SEAL.] ARTHUR B. MUSSMAN,
Clerk United States Circuit Court
of Appeals for the Sixth Circuit.

55 [File endorsement omitted.]

WASHINGTON : GOVERNMENT PRINTING OFFICE : 1924

In the Supreme Court of the United States.

OCTOBER TERM, 1922.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, petitioner,
v.
LOUIS STEARN, RESPONDENT.

No. —.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

The Solicitor General, on behalf of Harry H. Weiss, Collector of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit rendered in the above-entitled case on January 9, 1923, affirming a judgment entered by the District Court allowing the respondent to recover taxes paid under protest.

STATEMENT.

This is an action brought by the respondent to recover taxes assessed and paid to the Government, under protest, by virtue of the Revenue Law of 1916 (39 Stat. 757), upon shares of stock received in the National Acme Company growing out of an

apparent sale and termination of the National Acme Manufacturing Company.

This case was tried in the District Court and resulted in a judgment for the respondent. The Circuit Court of Appeals, taking the view that the transaction was merely a reorganization accompanied by a stock dividend, affirmed the judgment. Petitioner now seeks to have this judgment of the Circuit Court of Appeals affirming the judgment of the District Court reviewed by certiorari.

QUESTION INVOLVED.

The sole question involved is whether the respondent should be regarded for the purpose of income taxation under the Revenue Law of 1916 (39 Stat. 757) as having disposed of, with profit, only one-half of his respective holdings in the National Acme Manufacturing Company, or whether he should have been considered as having so disposed of the entirety.

THE FACTS.

Under a contract between the stockholders of the National Acme Manufacturing Company and Eastman, Dillon & Company, the stockholders sold all of the stock in the National Acme Manufacturing Company to the latter company and received for each share of the old stock $150 in cash and five shares in a newly organized "National Acme Company." Eastman, Dillon & Company, by virtue of this transaction, acquired a one-half interest in the newly organized company.

The petitioner contends that the profit was the difference between the March 1, 1913, value of the stock of the old National Acme Manufacturing Company and the entire consideration received in exchange therefor, consisting of cash and stock of the new National Acme Company.

REASONS FOR GRANTING THE PETITION.

1. The decision of the Circuit Court of Appeals is detrimental to the interests of the Government in the collection of revenue under the Revenue Law of 1916, as it is directly opposite to the ruling of the Treasury Department in pursuance of which large amounts of taxes have already been collected. If the decision stands, numerous other suits may be expected, with strong possibility of conflicting decisions in other circuits.

2. The question is of grave importance to the administration of the Internal Revenue Laws, which this decision leaves in great confusion.

3. The Circuit Court of Appeals erred in holding that the distribution upon reorganization of the new stock in exchange for the old did not involve taxable income.

JAMES M. BECK,
Solicitor General.

BRIEF IN SUPPORT OF THE PETITION.

I.

The court erred in holding that while as to one-half of the stock in the National Acme Manufacturing Company there was a sale from which the stockholders derived taxable income, yet as to the other half of the stock there was an exchange of stock for stock out of which exchange the old stockholders of the National Acme Manufacturing Company received no taxable income, but only a stock dividend.

The stockholders sold their shares in the National Acme Manufacturing Company for $150 cash and five (5) shares of stock in the new company for each share of stock in the old, the assets of the old company, including surplus, having been transferred to the new company. Certainly the undivided interest of the individual stockholder in the surplus accumulated had been released to and drawn by him as profit or income from his original capital investment. The distribution in stock to the stockholders of the National Acme Manufacturing Company resulted in taxable income regardless of the fact that this company was dissolved and never continued as a going concern after said distribution. The distribution in the present case can not be said to be a stock dividend, for in *Eisner* v. *Macomber*, 252 U. S. 189, 202, 203, it is stated that the essentials of a true stock dividend are that "a stock dividend really takes nothing from

the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. * * * The proportional interest of each shareholder remains the same."

In the present case the transaction was a sale of all the stock of the National Acme Manufacturing Company and while the corporate assets may have been the same upon its completion as they were at its inception, it is certainly not true that the stockholding interests were identical. It is believed that this question has been conclusively settled by the case of *United States* v. *Phellis*, 257 U. S. 156, wherein it was held that the distribution constituted a property dividend and was taxable as such in the hands of the stockholders. The court pointed out (p. 169) that—

> Hence the inquiry must be whether the shares of stock in the new company received by claimant as a dividend by reason of his ownership of stock in the old company constituted (to apply the tests laid down in *Eisner* v. *Macomber*, 252 U. S. 189, 207), a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested, and coming in, that is, received or drawn by the claimant for his separate use, benefit and disposal.

The distribution in question surely resulted in taxable income to the stockholders of the old company in the form of profit derived from the sale and exchange of their shares of stock in the National Acme Manufacturing Company for shares of stock in the National Acme Company and cash. The measure of the profit, gain, and income so derived is the difference between the fair market value of the stock of the National Acme Manufacturing Company on March 1, 1913, and the value of the entire consideration received in payment thereof, i. e., five shares of stock of the National Acme Company and $150 in cash for each share of stock of the National Acme Manufacturing Company.

Merchants Loan & Trust Company v. *Smietanka*, 255 U. S. 509.
Goodrich v. *Edwards*, 255 U. S. 527.
Walsh v. *Brewster*, 255 U. S. 536.

CONCLUSION.

It is respectfully submitted that a writ of certiorari should issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit to the end that it may be reversed.

JAMES M. BECK,
Solicitor General.

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

JOHN C. HAYES,
Special Assistant to the Attorney General.

APRIL, 1923.

○

No. 935

Office Supreme Court
FILED
APR 11 192
WM. R. STANS
CL

In the Supreme Court of the United States

OCTOBER TERM, 1922.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE,
Petitioner,

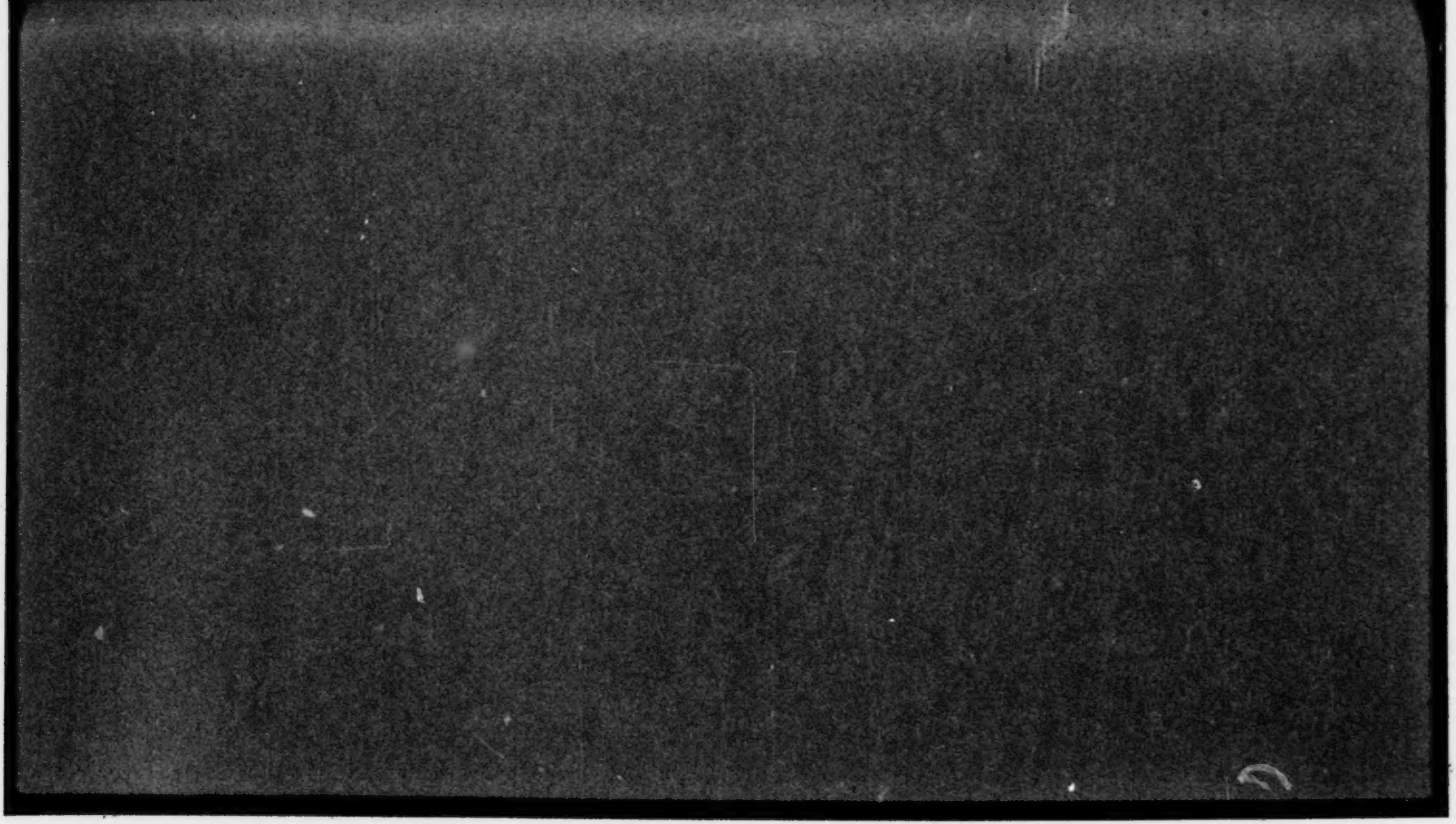
vs.

LOUIS STEARN,
Respondent.

BRIEF OF RESPONDENT, LOUIS STEARN, IN OPPOSITION TO PETITION FOR CERTIORARI.

THOMPSON, HINE & FLORY,
Attorneys for Respondent.

CHARLES P. HINE,
Of Counsel.



No.....

In the Supreme Court of the United States

October Term, 1922.

Harry H. Weiss, Collector of Internal Revenue,
Petitioner,

vs.

Louis Stearn,
Respondent.

BRIEF OF RESPONDENT, LOUIS STEARN, IN OPPOSITION TO PETITION FOR CERTIORARI.

I.

The case is not one of general public interest or importance. It turns on the construction of the language of a long and complicated contract, and the steps taken to carry out such contract, and will therefore be of little or no value as a precedent in cases involving other companies. The opinion of the District Court states:

> "Whether or not the plaintiff is entitled to recover depends upon the correct understanding and meaning of the agreement in writing, dated November 8, 1916, executed by W. D. B. Alexander, A. W. Henn and E. C. Henn, parties of the first part, and Eastman, Dillon & Company, of New York, parties of the second part."

II.

The Statement of Fact in the brief in support of the petition that there was a sale by stockholders of all of their stock, is not correct, as appears from the following quotation from the opinion of the Circuit Court of Appeals:

> "There was nothing that can properly be called a sale of one-half the stock under consideration in any aspect of the case."

III.

The tax which the government collected from stockholders in The National Acme Manufacturing Company was based on an entirely fictitious profit. Those stockholders who still hold their stock in The National Acme Company retained one-half of their original capital investment just as truly as if they still held one-half of their original certificates in The National Acme Manufacturing Company. It is grossly unjust that such stockholders should be taxed as if they had sold such original interest at the rate of Three Hundred Dollars ($300.00) per share. It is unjust that stockholders who have actually sold their new certificates at Twelve or Fifteen Dollars per share during the past few years should be taxed on the basis of having realized Thirty Dollars ($30.00) per share in 1916. As to such stockholders, the government first charges them with a fictitious profit and then is obliged to allow them a fictitious loss. No question of general interest or of great importance to the government is presented since

1. The case affects only a few stockholders of a single corporation, i. e. those who have preserved their rights by filing claims for refund and by commencing

suit. The statute of limitations has run against other stockholders.

2. The decision does not prevent the imposition of taxes on all profits realized from the transaction involved, but requires the imposition of taxes as and when such profits are realized.

3. The decision below, even if it is applicable to other reorganizations, can affect the liability of taxpayers only for the years prior to 1918, since the Revenue Acts of 1918 and 1921 specifically provide that no taxable income is realized as a result of such reorganizations.

IV.

The Solicitor of the Internal Revenue Department and the District Attorney contended in the Court of Appeals that the case was governed by *United States vs. Phellis*, 257 U. S. 156, and other cases cited in the brief of the petitioner in this Court. Such contentions, as the court will see by examination of the opinion of the Circuit Court of Appeals, were fully considered by that court. That court said:

> "Except for change of corporate entity there was here a continuance of the same concern. The assets were the same, and the stockholders (assuming the sale of the other half to have been consummated) were the same, and in the same proportions; the domicile, the powers, the name, substantially, and the corporate obligations were all left as before. *The same ends might have been achieved by an amendment of the articles of incorporation providing for the increase of the capital stock, the reduction of the face value of its shares, and the change of name. Had this method of accomplishing the identical result been pursued, the*

increase in face value of the new certificates issued to the holders in exchange for the old would have been plainly a mere stock dividend, non-taxable under Eisner vs. Macomber, 252 U. S. 189. Therefore, if the transaction be taxable it must be because of the giving up of the old and the taking on of the new charter. It is true that a new corporate being has intervened, but where a corporate entity had been found to be a mere matter of form, it has been disregarded in similar transactions in respect to income taxation. *Southern Pacific Co. vs. Lowe*, 247 U. S. 330; *Gulf Oil Co. vs. Llewellyn*, 248 U. S. 71; *Alpha Portland Cement Co. vs. United States*, 261 Fed. 339; although it is not so when it is a matter of substance. *Eisner vs. Macomber* and *United States vs. Phellis, supra.* The latter case, strongly relied upon by plaintiff in error, does not present a parallel situation. There the surplus had been separated from the capital for the purpose of distributing it among the stockholders in the form of the stock of a new corporation to which the assets were conveyed. But the old corporation continued to exist, its stock remained outstanding, and the segregation of capital from surplus was accomplished by setting over to it assets equal to its capital stock and capable of returning future dividends to its stockholders. * * * *Peabody vs. Eisner*, 247 U. S. 347, exhibited the case of a distribution, as a dividend, of the stock of another corporation held by the parent company. In each of those cases there was a segregation of accumulated surplus and a distribution of it in the stock of a corporation other than the parent company, both corporations continuing to exist.

In the present case there has been no attempt on the part of the concern to segregate or distribute its surplus, but merely a reorganization accompanied by a stock dividend. It has not been divided into two corporations, one to hold the capital, the

other to take the earnings, as in the cited cases. The old charter was surrendered when the new one was taken. The venture of the stockholder in the hazard of the business continues undivided. He has not drawn out his profit. His investment is still entirely in the same enterprise, albeit represented by new certificates, yet essentially the same." (Italics ours.)

That the points of difference between the facts of the *Phellis* case and the facts of the present case were numerous and important, appears from the following quotations.

In the *Phellis* case this Court stated:

> "Each holder of the New Jersey company's common stock, including claimant, retained his old stock, and besides received a dividend of two shares for one in stock of the Delaware company, and the New Jersey company retained in its treasury six per cent. debenture stock of the Delaware company equivalent to the par value of its own outstanding common stock."

In the present case the stockholders did not retain their stock in the old company, and the old company retained nothing in its treasury.

In the *Phellis* case this Court said:

> "After the reorganization and distribution of the stock of the Delaware company the New Jersey company continued as a going concern and still exists."

In the present case the old corporation was dissolved.

In its opinion in the *Phellis* case this Court, after pointing out that the new company was formed under the laws of a different state, and after mentioning many other facts which distinguish the facts of that case from the present, says:

"In the light of all this we cannot regard the new company as virtually identical with the old."

As pointed out in the above quotation from the opinion of the Circuit Court of Appeals, the same identical result which was achieved in the present case could have been accomplished by the amendment of the Articles of Incorporation of the old company, and the declaration of a stock dividend. It is conceded that no income would have been realized if the result had been reached through the medium of a stock dividend. The right of the Government to impose a tax on income depends on whether income has been realized. We maintain that the axiom that, "Things which are equal to the same thing, are equal to each other", is applicable in law, as well as in mathematics; that since this Court has held in *Eisner vs. Macomber*, 252 U. S. 189, that no income would be realized by the result of the transaction, the court cannot consistently hold that income has been realized when the same result is reached through another form of procedure.

Neither the 1913 nor the 1916 income tax laws contained any provision which dealt expressly with the subject of an exchange of property. It was left to the courts to determine whether, in any particular case, income had been realized through an exchange. The subject of taxable income from an exchange, is, however, dealt with in detail in the present revenue act, Section 202 (C); and we submit that that act expresses in the form of statute law, principles which should govern the Revenue Department, and the courts, in their construction of general language in former acts. We quote the portion of Section 202 (C) which expressly forbids the imposition of such a tax as that in the instant case.

"Sec. 202 (C) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—* * *

(2) 'When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected).'"

For the reasons above stated, we submit that there is no question of general interest, that there is no error in the judgment below, but that on the contrary, the decision is in accordance with the principles announced and applied by this Court in *Eisner vs. Macomber*, 252 U. S. 189, and *United States vs. Phellis*, 257 U. S. 156.

Respectfully submitted,

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Attorneys for Respondent

CHARLES P. HINE,
Of Counsel.

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In the Supreme Court of the United States.

OCTOBER TERM, 1923.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, petitioner,
v.
LOUIS STEARN. } No. 262

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, petitioner,
v.
JOHN G. WHITE. } No. 263

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR THE PETITIONER.

STATEMENT OF THE CASE.

These writs of certiorari are to review judgments of the Circuit Court of Appeals for the Sixth Circuit, affirming judgments of the United States District Court for the Northern District of Ohio. The respondents here were plaintiffs in the District Court and brought actions against the Collector of Internal Revenue to recover amounts paid as income taxes

after appropriate proceedings had been taken before the Bureau of Internal Revenue. The District Court decided in favor of the plaintiffs, rendering judgments against the Collector, and these judgments have been affirmed by the Circuit Court of Appeals.

THE FACTS.

Each of the plaintiffs was a stockholder in the National Acme Manufacturing Company, an Ohio corporation, whose assets were acquired by another corporation called The National Acme Company. The question involved is the amount of taxable income received by the stockholders in the transaction. One opinion was written in the two cases by the Circuit Court of Appeals, and the question involved in each is the same, the only difference in the facts being that Stearn, respondent in No. 262, was the owner of 105 shares of stock of the National Acme Manufacturing Company, while White, respondent in No. 263, was the owner of 670 shares.

On March 1, 1916, the National Acme Manufacturing Company had an outstanding capital stock of $4,000,000, divided into $1,500,000 preferred stock and $2,500,000 of common stock, each share being of the par value of $100.

On March 15, 1916, a stock dividend of 100 per cent was declared by the corporation, payable to the holders of common stock, which was thereby increased to $5,000,000.

On November 8, 1916, arrangements had been made for the retirement of the preferred stock, so

that for purposes of this case the entire outstanding capital stock of the company on that date was $5,000,000 common stock, consisting of 50,000 shares of the par value of $100 each.

On November 8, 1916, an agreement was made between W. D. B. Alexander, A. W. Henn, and E. C. Henn, parties of the first part, designated as "vendors," and Messrs. Eastman, Dillon & Company, parties of the second part, designated "purchasers," which agreement is set forth beginning at page 7 of the transcript in the White case, No. 263.[1] The agreement, after reciting that the vendors were the owners of more than 14,000 shares of the common capital stock of the National Acme Manufacturing Company and that the purchasers desired to acquire the same and such other shares as might be deposited thereunder, provided as follows:

> First. The vendors agree to, and will sell all their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at and for the price of three hundred dollars ($300.00) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth; provided, however, and this contract is made

[1] The page references are to the transcript in No. 263 unless otherwise noted.

upon the express condition, that it shall not become operative unless, on or before December 1st, A. D. 1916, at least eighty per centum (80%) of the entire outstanding common capital stock of said company is deposited hereunder, for sale in accordance with the terms hereof, with said depositary.

The second paragraph of the agreement recites that the vendors have exhibited to the purchasers a financial statement of the company and have made certain representations and provides that the purchasers might, if they desired, make an examination of the company's books and properties, and should on or before December 4th advise the vendors of the results of their examination. Upon certain contingencies which might be revealed by the examination the agreement was to be cancelled, otherwise it was to be carried out. Under the third paragraph the vendors were to deliver to the Cleveland Trust Company as depositary certificates of all their shares of the common stock duly endorsed for transfer and subject to the terms of the agreement and were to attempt to procure the deposit by all the other stockholders of their shares and to constitute the vendors attorneys in fact and proxies of the depositing stockholders to vote the stock in such manner as might be necessary to carry out the purposes of the agreement. If and whenever, on or before December 1, 1916, the depositary should notify the purchasers that there had been deposited with it at least 80 per cent of all the outstanding stock, the purchasers

agreed within five days to deposit with the Cleveland Trust Company or for its account, at the Chase National Bank in the City of New York, the sum of $500,000 and the further sum of $7,000,000 within five days thereafter.

By the fourth paragraph the purchaser and vendors agreed to cause to be incorporated under the laws of the State of Ohio a manufacturing corporation, with powers generally similar to those of the National Acme Manufacturing Company, under the corporate name of The National Acme Company, or such other name similar thereto as the parties might desire. That corporation was to have an authorized capital stock of $25,000,000 of common stock, divided into 500,000 shares of the par value of $50 each. Upon the organization of that corporation the purchasers and vendors were to cause such proceedings to be had by its stockholders and directors as would cause it to purchase all the property and assets of the National Acme Manufacturing Company, subject to all its outstanding contracts and liabilities in consideration of the sum of $25,000,000, payable by its entire authorized issue of stock, and to issue such stock in payment therefor. The purchasers and vendors also agreed to use their best endeavor to cause such proceedings to be had by the stockholders and directors of the old company as would cause all its property and assets to be sold to the new company at the price and on the terms set forth, and to receive in payment therefor the capital stock of the

new company. And the purchasers and vendors also agreed to cause all the stock of the new company, except nine qualifying shares for directors, to be issued to the Cleveland Trust Company, depositary, to be held and distributed by it as provided in the fifth paragraph of the agreement.

By the fifth paragraph the depositary was to distribute the shares of stock and the $7,500,000 as follows: The purchasers were to receive 250,000 shares less four qualifying shares—that is, one-half of the stock of the newly organized company, and the depositing stockholders of the old corporation were to receive the $7,500.00 on the basis of $150 per share. The remaining half of the stock of the new corporation—that is, 250,000 shares, excluding five qualifying shares—was to be retained by the trustee until May 31, 1917, unless and to the extent that the purchasers might consent to earlier deliveries, at the expiration of which time it was to cause the stock to be assigned and transferred to the depositing stockholders or their assignees *pro rata*. The agreement further provides for distribution by the depositary of the cash and stock in case the entire amount of the stock of the old company should not be deposited.

The vendors "being the active executive officers" of the old company, agreed to accept and retain, if elected thereto, for a period of five years after its organization, the same or similar positions with the new company, "it being the desire of both parties hereto that the present management of the business

be not interfered with by its transfer to the new company." Upon the organization of the new company its board of directors was to consist of nine, of whom four were to be nominated by the purchasers and five by the vendors. Both purchasers and vendors agreed to cause the new corporation to make application to have its stock listed upon the New York, Boston, and Cleveland stock exchanges. The expenses of the formation of the new company, transfer of assets and the dissolution of the old company, which was to be effected as soon as it legally might be, were to be borne by the new company. It was finally provided that if, in carrying out the terms of the contract, it was deemed advisable to make any modifications, the matter should be submitted to two gentlemen named, who might make such modifications or additions as they deemed advisable or desirable "other than change in price of the stock sold or time of payment therefor which they [had] no power to modify."

This agreement was carried out, each stockholder of the old company receiving for each share of his stock $150 in cash and five shares of stock in the new company. The courts below held that for income-tax purposes the transaction represented a sale by each stockholder of one-half of his stock in the old company for $150 in cash. The contention of the Government is that it represented a sale of his entire stock for $150 in cash and five shares of stock in the new company of the agreed value of $30 per share.

THE STATUTE.

The statute is Section 2 (a) of the Revenue Act of September 8, 1916, c. 463, 39 Stat. 756, 757, as follows:

> That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: *Provided*, That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of its cash value.

ARGUMENT.

I.

The transaction between the respondents and Eastman, Dillon & Company was in fact and legal effect a sale by the respondents of all their stock in the National Acme Manufacturing Company for $300 a share, payable $150 in cash and $150 in securities of another corporation.

The transaction, of course, must be considered in the light of the agreement. That agreement was evidently drawn with care, is free from ambiguity, and expresses clearly a definite intent. The vendors agree to and will sell all their shares, and the purchasers agree to and will purchase the same from them, as well as any and all shares, the holders of which deposit them with the depositary named, for the price of $300 per share, payable one-half in cash and one-half in securities "as hereinafter set forth." Nothing could be clearer, and it is the position of the Government that this agreement amounted exactly to what it said and that the transaction was a sale by the respondents of their stock in the National Acme Manufacturing Company for $300 a share, payable half in cash and half in securities of another corporation. The contract was made upon the express condition that it should not become operative unless at least 80 per cent of the entire outstanding stock should be deposited "for sale." Of course it is apparent that the purpose of Eastman, Dillon & Company, the purchasers, was to become the owners of a half interest in a very profitable business, and

we all know that one who holds 50 per cent of the stock of a corporation practically controls it, where the other half is held by numerous stockholders. The other terms of the agreement show that the purchasers were not buying one-half of the stockholders' stock. They were purchasing the company for the purpose of reorganizing it and placing themselves in control, so the agreement provides that they shall have an opportunity to investigate the representations made by the vendors with respect to the earnings of the company and the title to the company's property, and, if that examination was unsatisfactory, the purchasers would not be required to carry out the agreement.

The vendors, owning 14,000 shares out of a total issue of 50,000 shares, were to deposit their stock with the depositary, as were all other stockholders who wished to take advantage of the agreement. The stock, as is usual in such transactions, was to be endorsed in blank for transfer, so as to constitute the vendors attorneys in fact and proxies, which would enable them, of course, to vote the stock as it became necessary to transfer the assets to the new company and dissolve the old one. The use of the words "vendors" and "purchasers" throughout the agreement shows that these words were used in no other sense than the usual one of such language in similar agreements. The provision contained in subdivision B of paragraph five of the agreement is significant. If less than the entire

amount of the capital stock of the National Acme Manufacturing Company was deposited, the depositary was to retain ten shares of stock of the new company and $150 in cash on account of each share not deposited until "adjustment for the purchase of such nondeposited stock under the laws of Ohio, or otherwise, can be had." The "purchasers" were to make whatever adjustment might be necessary to acquire such nondeposited stock and to that end might use the shares of stock and money retained by the depositary, and, when the nondeposited stock had been acquired "by the purchasers," the depositary was to turn over to the purchasers any shares or money then remaining in its hands, provided, however, that the vendors, if they desired, should have the right to proceed "in the purchase of such nondeposited stock to the extent and upon the terms which may be deemed equitable" by Messrs. Wiggin and Goff, and with the further provision that in lieu of their portion of the retained stock the purchasers might substitute and deposit such other collateral as might be approved by Messrs. Wiggin and Goff. The concluding paragraph of the agreement is also significant, providing for modifications or additions to be made by Messrs. Wiggin and Goff but denying them power to modify in regard to "prices of the stock sold or time of payment therefor."

II.

The excess of both the cash and the value of the National Acme Company's stock, received by the respondents, over the value of the National Acme Manufacturing Company's stock as of March 1, 1913, or, in the case of stock purchased since that date, its cost, was income for the year 1916.

The transaction whereby the respondents disposed of their stock in the National Acme Manufacturing Company comes clearly within the language of the act taxing profits derived from "sales or dealings in property."

The receipt of property may as well constitute income to the taxpayer as the receipt of money. In *Peabody* v. *Eisner*, 247 U. S. 347, the value of Baltimore & Ohio Railroad stock owned by the Union Pacific Railroad and distributed by the latter to its stockholders as a dividend was held to constitute taxable income. See also *Eisner* v. *Macomber*, 252 U. S. 189; *United States* v. *Phellis*, 257 U. S. 156. The respondents converted property of one kind into cash and other property having an agreed value. This resulted in taxable income.

The plaintiff sold his stock in the National Acme Manufacturing Company to Eastman, Dillon & Company for $150 cash per share and securities in a new, separate and distinct corporation, and thereby realized a gain severed from his capital interest in the National Acme Manufacturing Company, the old corporation. He received in cash his capital interest in that company, namely, the par value of $100 a

share, and in addition realized a profit per share of $50 cash and securities in another corporation. Before the transaction his stock in The National Acme Manufacturing Company reflected his original capital investment plus the accretions which had resulted through the company's business activities and constituted its surplus, a surplus in which he as an individual stockholder had no property interest except as it increased the valuation of his capital. When, however, he sold that stock for its par value and received in addition cash and securities in another corporation it is clear that he received assets of exchangeable and actual value severed from his capital interest in the old company.

In support of the foregoing attention is called to the cases of *United States* v. *Phellis*, 257 U. S. 156, *Rockefeller* v. *United States*, 257 U. S. 176, and *Cullinan* v. *Walker*, 262 U. S. 134.

In *United States* v. *Phellis, supra*, a New Jersey Corporation, having a large surplus of accumulated profits transferred its assets and good will to a new corporation incorporated under the laws of Delaware, with an authorized capital stock almost four times that of the old corporation. The new corporation had the same stockholders and officers and did the same business as the old corporation. The old corporation continued to exist, its only assets being debenture bonds equivalent to its outstanding common stock. The stock of the new corporation was distributed to the stockholders of the old corporation, two shares for one. This Court held that the value of the stock thus dis-

tributed was taxable as income. Among other things the Court said (pp. 169, 170):

> Hence the inquiry must be whether the shares of stock in the new company received by claimant as a dividend by reason of his ownership of stock in the old company constituted (to apply the tests laid down in *Eisner* v. *Macomber*, 252 U. S. 189, 207), a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested, and coming in, that is, received or drawn by the claimant for his separate use, benefit, and disposal. * * *
>
> Upon the face of things, however, the transfer of the old company's assets to the new company in exchange for the securities issued by the latter, and the distribution of those securities by the old company among its stockholders, changed the former situation materially. The common stock of the new company, after its transfer to the old company and prior to its distribution, constituted assets of the old company which it now held to represent its surplus of accumulated profits—still however a common fund in which the individual stockholders of the old company had no separate interest. But when this common stock was distributed among the common stockholders of the old company as a dividend, then at once—unless the two companies must be regarded as substantially identical—the individual stockholders of the old company, including claimant,

> received assets of exchangeable and actual value severed from their capital interest in the old company, proceeding from it as the result of a division of former corporate profits, and drawn by them severally for their individual and separate use and benefit. Such a gain resulting from their ownership of stock in the old company and proceeding from it constituted individual income in the proper sense.
>
> * * * the value of the New Jersey shares immediately prior to the transaction reflected the original capital investment plus the accretions which had resulted through the company's business activities and constituted its surplus; a surplus in which, until dividend made, the individual stockholder had no property interest except as it increased the valuation of his capital. It is the appropriate function of a dividend to convert a part of a surplus thus accumulated from property of the company into property of the individual stockholders; the stockholder's share being thereby released to and drawn by him as profits or income derived from the company.

It will be noted that in the *Phellis case* the stockholders in the New Jersey corporation retained their stock therein, whose par value was secured by debenture bonds, and received stock in the Delaware company to which all assets of the New Jersey company, with the exception of the debenture bonds, had been transferred. The Court held that under these facts the individual stockholders of the New Jersey company "received assets of exchangeable

and actual value severed from their capital interest in the old company, proceeding from it as the result of a division of former corporate profits, and drawn by them severally for their individual and separate use and benefit."

The question in the case at bar is whether the stockholders of the National Acme Manufacturing Company by virtue of the agreement with Eastman, Dillon & Company received assets of exchangeable and actual value severed from their capital interest in the old company. It is submitted that they did. In the *Phellis case* the New Jersey corporation, after transferring all its assets to the Delaware corporation, except an amount equivalent to its outstanding capital stock, continued to exist. The stockholders, when they received the distribution of stock from the Delaware corporation, received assets severed from their capital interest in the New Jersey corporation. A like situation is presented in this case, for while the National Acme Manufacturing Company did not continue to exist, and its assets were transferred in their entirety to The National Acme Company *after* the sale of its stock to Eastman, Dillon & Company, the stockholders thereof received assets severed from their capital interest before the transfer of the assets. That is to say, while the old corporation was in existence the stockholders sold their stock to Eastman, Dillon & Company and thereafter the assets of the old corporation were transferred to the new company. The stockholders of the old corporation received $150 cash and five shares of

stock in the new corporation for each share owned in the old corporation. Their capital interest, namely, the par value of their stock ($100), was returned in cash, and this they could use as they pleased without in any way affecting the additional amount of $50 per share and the five shares of stock in the new corporation. In other words, the additional $50 and the new stock were "*ab extra*," something drawn from, proceeding out of, capital. *Eisner* v. *Macomber*, 252 U. S. 189, 207. The $50 cash and securities received for each share of National Acme Manufacturing Company stock, therefore, constituted taxable gain severed from the capital interest.

The case of *Cullinan* v. *Walker*, 262 U. S. 134, involved the question of taxable income received by a stockholder in connection with the so-called reorganization of an oil corporation, and this Court there held that the gain accruing to a stockholder through enhancement of the value of his shares, and which, when segregated, becomes legally income subject to the income tax, may be segregated by a dividend made on liquidation of the corporation as well as by an ordinary dividend. That case arose under the same statute as is here involved. An oil corporation was dissolved. Its trustees in liquidation formed a producing corporation and a pipe line corporation in the same State. They transferred one-half of the assets to each, receiving from each in return its stock and its bonds, and transferred all this stock to a holding corporation which they formed in another State, receiving in exchange its stock. This stock,

with the bonds of the other existing corporations, they distributed among the persons who had been the stockholders of the dissolved concern. The three new corporations had at the time of the distribution no assets other than so received from the trustees, and the value of the assets was the same as when the trustees held them. This Court held that the securities thus distributed were not in legal effect a stock dividend and that the distributee was taxable under the Act of September 8, 1916, upon the amount by which the securities he received exceeded in value his investment in the shares of the original corporation. This Court, in an opinion by Mr. Justice Brandeis, said (p. 137):

> Cullinan insists that his gain so ascertained was merely an incident of a reorganization. This was equally true in the *Phellis* and the *Rockefeller Cases*. It is sought to differentiate those cases on the ground that there the distributed stock of the new corporation was technically a dividend paid out of surplus; and that here the segregation is not of that character. But the gain, which when segregated becomes legally income subject to the tax, may be segregated by a dividend in liquidation, as well as by the ordinary dividend. If the trustees in liquidation had sold all the assets for $6,000,000 in cash, and had distributed all of that, no one would question that the late stockholders of Farmers Petroleum Company would, in the aggregate, have received a gain of $5,900,000, taxable as income. The result would obviously have

been the same, if the trustees had taken in payment, and distributed, bonds of the value of $6,000,000, in some new corporations. And the result must, also, be the same where that taken in payment is $3,000,000 of such bonds and $3,000,000 in stock of a third corporation. All the material elements which differentiate the *Phellis* and *Rockefeller Cases* from *Eisner* v. *Macomber* are present also here.

Of course, in the present case the details are ifferent, but the principles are, we submit, the sa.ne. ll the assets of the old corporation were transferred o the new corporation in exchange for its capital tock. That left the old corporation with no assets xcept the capital stock of the new corporation. he old corporation was then liquidated and all that had was distributed to its stockholders, through he depositary as intermediary. The old corpora- on ceased to exist, and those who had been its tockholders received for each share of its stock 150 in cash and five shares of stock in the new orporation of a par value of $50 each, and an agreed alue of $30 each. That the new corporation was rganized under the laws of the same State as the old orporation is not material; that its powers and name ere generally similar is not material. It was a holly different entity, with a wholly different apitalization. The interest of each stockholder in he old corporation was wholly different from its nterest in the new corporation, and, as a practical natter, his power to control the new corporation as quite different. The real control had passed

from him and those with whom he had been associated and had gone to the men who had invested in the enterprise $7,500,000 in cash.

The Court of Claims in a case recently decided, *Walter L. Marr* v. *The United States*, decided November 21, 1923, regarded the case of *Cullinan* v. *Walker* as decisive of the case then before it. That court rendered a memorandum decision, which we quote in full, as follows:

> The plaintiff exchanged stock in the New Jersey corporation for stock in the Delaware corporation on the basis of five shares for one. Preferred stock was exchanged on a different basis, but all of the preferred stock was not exchanged, and holders of that kind who declined to make the proposed exchange were paid in cash for their preferred stock. Having acquired all of the stock in the New Jersey corporation, the Delaware corporation caused all of the former's assets and liabilities to be transferred to itself and the New Jersey corporation to be dissolved.
>
> The Delaware corporation had $82,600,000 of common stock and used $75,000,000 of it in acquiring the outstanding stock in the New Jersey corporation. It sold and realized cash for some of its stock in excess of that involved in the exchange. It thus had after the transfer all of the property the New Jersey corporation owned and some cash, realized, as stated, from its treasury stock.
>
> Plainly the transactions involved two distinct entities, organized under the laws of different States, with different powers, and

with different capital. Plaintiff exchanged his stock in one of these entities for stock in the other. This was an exchange of property.

When the exchange became effective we think that the plaintiff "in a legal sense realized his gain." *Cullinan* v. *Walker*, 262 U. S. 134; *Phellis case*, 257 U. S. 156; *Rockefeller case*, 257 U. S. 176.

So in the case at bar. When the exchange had been completed, each stockholder had realized his entire investment and profit in the old company, even though he immediately put part of it into a new venture.

It is submitted, therefore, that when the plaintiff below sold his stock in the National Acme Manufacturing Company for $300 a share, payable $150 in cash and $150 in securities of another corporation, he received assets of exchangeable and actual value severed from his capital interest in the Manufacturing Company, and the resulting gain constituted taxable income.

III.

The National Acme Company stock received by respondents was, in fact and legal effect, different property from the National Acme Manufacturing Company stock which they disposed of.

It was contended by the respondents that looking to the substance of the transaction, the stockholders of the National Acme Manufacturing Company sold but one-half of their interest in that company, and that the sale and subsequent organization of The National Acme Company was but a financial reorganization of the business as before constituted,

there being no loss of essential identity on the part of the company. On the other hand it was contended by the Government that the transaction was what it purported to be, a sale by the stockholders of the National Acme Manufacturing Company of all their stock in that company for cash and stock in The National Acme Company, a new, separate and distinct corporation.

It is an established principle that the ownership by one corporation of the stock of another corporation, or the ownership by the stockholders of one corporation of the stock of another corporation, does not destroy the distinct legal entity of the two corporations. *Pullman Palace Car Co.* v. *Missouri Pacific Co.*, 115 U. S. 587, 597; *Peterson* v. *Chicago, Rock Island & Pacific Ry. Co.*, 205 U. S. 364, 391.

In cases involving taxation the courts have consistently refused to disregard the principle of corporate entity. As said in *Eisner* v. *Macomber*, 252 U. S. 189, at page 214:

> * * * We must treat the corporation as a substantial entity separate from the stockholder, not only because such is the practical fact but because it is only by recognizing such separateness that any dividend—even one paid in money or property—can be regarded as income of the stockholder. Did we regard corporation and stockholders as altogether identical, there would be no income except as the corporation acquired it; and while this would be taxable against the corporation as income under appropriate provisions of law, the individual stockholders could not be separately

and additionally taxed with respect to their several shares even when divided, since if there were entire identity between them and the company they could not be regarded as receiving anything from it, any more than if one's money were to be removed from one pocket to another.

In *Osgood* v. *Tax Commissioner*, 235 Mass. 88, there was involved the Massachusetts Income Tax Law of 1916. The facts in that case were four-square with the facts, as the plaintiff below construes them, in the case at bar. From the standpoint of the plaintiff below, therefore, the case cited is directly in point. The court said (pp. 91–92):

> On analysis, the transaction out of which this controversy arises was this: The petitioner was the owner of stocks of an ascertained value on January 1, 1916. In the following July, without selling these stocks for cash, she used them as the consideration with which to subscribe for and acquire by purchase other stocks in a new and different corporation. Although the property owned by the new corporation was identical with that owned by the old corporation, it nevertheless plainly was a different legal entity. *Brighton Packing Co.* v. *Butchers Slaughtering & Melting Association*, 211 Mass. 398. *Marsch* v. *Southern New England Railroad*, 230 Mass. 483, 498. The stock obtained by the petitioner through exchange was different in kind and not merely in degree from that which she owned before. It was not the same corporation and the stock itself was different in nature. A change of investment had been

made both in name and in essence. It would seem something of a wrench to say that the disposal of the stock in the old corporation for stock in the new is not a sale for purposes of taxation, when, if the same transaction was presented for consideration under the sales act, it would inevitably be treated as a sale. It hardly would be consistent to hold that exchanging grain for spirituous liquors was a sale constituting a crime, as was held by this court in *Commonwealth* v. *Clark*, 14 Gray, 367, and to say that exchanging stock in one corporation for stock in another corporation was not a sale for taxation purposes. Whether the disposal of the stock in the old company be treated as a strict sale or not, there seems to be no escape from holding that the procurement of the stock in the new corporation was a purchase. That word, unless narrowed by its context, signifies the acquisition of title to any commodity for cash, on credit, or for any other equivalent agreed upon. This is its ordinary meaning according to the common understanding of the business world. *Berger* v. *United States Steel Corp.*, 18 Dick. 809, 817. Doubtless there are connections in which the word is used in a more restricted sense. *Robotham* v. *Prudential Ins. Co.*, 19 Dick. 673, 685. *People* v. *Duffy-McInnerney Co.*, 122 App. Div. (N. Y.) 336, affirmed in 193 N. Y. 636. There is nothing in the context of the present statute to indicate limitations upon the natural meaning of the word. "Purchase," both in its popular and in its legal signification is broad enough to include the acquirement of stock through subscription as well as by bidding on the stock exchange.

> Tested by the difference in value of the stocks purchased as compared with those exchanged for them at their appraisal at the time fixed by § 7 of the act, the petitioner had realized a gain. * * *

See also *Stone* v. *Tax Commissioner*, 235 Mass. 93.

In *United States* v. *Phellis*, 257 U. S. 156, the taxpayer contended that the transaction there involved was but a financial reorganization of the business as it was constituted before and that there was no loss of essential identity on the part of the company.

The Court said (pp. 172–174):

> In such matters, what was done, rather than the design and purpose of the participants, should be the test. However, in this case there is no difference. The proposed plan was set out in a written communication from the president of the New Jersey corporation to the stockholders, a written assent signed by about 90 per cent of the stockholders, a written agreement made between the old company and the new, and a bill of sale made by the former to the latter, all of which are in the findings. The plan as thus proposed and adopted, and as carried out, involved the formation of a *new corporation* to take over the business and the business assets of the old; it was to be and was formed under the laws of a *different State*, which necessarily imports a different measure of responsibility to the public, and presumably different rights between stockholders and company and between stockholders *inter sese*, than before. The articles of association of neither company

are made to appear, but in favor of the asserted identity between the companies we will assume (contrary to the probabilities) that there was no significant difference here. But the new company was to have authorized capital stock aggregating $240,000,000—nearly four times the aggregate stock issues and funded debt of the old company—of which less than one-half ($118,515,900) was to be issued presently to the old company or its stockholders, leaving the future disposition of a majority of the authorized new issues still to be determined. There was no present change of officers or stockholders, but manifestly a continuation of identity in this respect depended upon continued unanimous consent or concurrent action of a multitude of individual stockholders actuated by motives and influences necessarily to some extent divergent. In the light of all this we can not regard the new company as virtually identical with the old, but must treat it as a substantial corporate body with its own separate identity, and its stockholders as having property rights and interests materially different from those incident to ownership of stock in the old company.

The findings show that it was intended to be established as such, and that it was so created in fact and in law. There is nothing to warrant us in treating this separateness as imaginary, unless the identity of the body of stockholders and the transfer *in solido* of the manufacturing business and assets from the old company to the new necessarily have that effect. But the identity of stockholders was

> but a temporary condition, subject to change at any moment at the option of any individual. As to the assets, the very fact of their transfer from one company to the other evidenced the actual separateness of the two companies.

In the case at bar it is clear that the stockholders of the old corporation received in addition to cash, stock in a new, separate, and distinct corporation. All the considerations, except that of incorporation under the laws of different States, mentioned by the Court in the *Phellis case* as supporting the corporate entities of the corporations there in question, are present here. Furthermore, while in the *Phellis case* the stockholders of the two corporations were identical, in the case at bar the stockholders of the National Acme Manufacturing Company and The National Acme Company were not identical. After the sale Eastman, Dillon & Company owned all the stock of the Manufacturing Company, whereas the stock of the new corporation, The National Acme Company, was owned by Eastman, Dillon & Company and the old stockholders of the Manufacturing Company.

The decisions of the Supreme Court in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71, are clearly distinguishable from the instant case.

In *Southern Pacific Co.* v. *Lowe*, the Southern Pacific Company prior to March 1, 1913, owned all of the stock of the Central Pacific Railway Company and "*was in the actual physical possession of the railroads and all other assets*" and "*in charge of its*

operations," and "*acted as cashier and banker of the entire system.*" The Central Pacific kept no bank account, and if it needed money for additions or betterments or otherwise the necessary funds were advanced by the Southern Pacific. In short, the Central Pacific was a mere name, and the Court held that the Southern Pacific had the full ownership and control of the company and its property and assets. The Court expressly limited its opinion to the case before it, saying that it rested on "its very peculiar facts."

This case is distinguished in *Peabody* v. *Eisner*, 247 U. S. 347, on page 349, as follows:

> *Southern Pacific Co.* v. *Lowe*, has been reversed this day, *ante*, 330, but only upon the ground that the Central Pacific Railway Company, which paid the dividend, and the Southern Pacific Company, which received it, were in substance identical corporations because of the complete ownership and control which the latter possessed over the former as stockholder and in other capacities, so that while the two companies were separate legal entities, yet in fact and for all practical purposes the former was but a part of the latter, acting merely as its agent and subject in all things to its direction and control; and for the further reason that the funds represented by the dividend were in the actual possession and control of the Southern Pacific Company as well before as after the declaration of the dividend.

See also the distinction made in *Lynch* v. *Hornby*, 247 U. S. 339, on page 346.

In the *Gulf Oil Corporation case*, 248 U. S. 71, the Gulf Oil Company "was a holding company *owning all the stock* in the other corporations concerned excepting the qualifying shares held by the directors. These companies with others *constituted a single enterprise.*"

(a) *The fact that the respondents acquired no increase in aggregate wealth through the sale or exchange of their stock in the National Acme Manufacturing Company is not material in determining whether they experienced a realization of profits constituting income.*

It is submitted that the fact that the respondents acquired no increase in aggregate wealth through the sale or exchange is not material. The real question is whether they experienced a realization of profits constituting income. It seems sufficient to quote the language of the Supreme Court in *United States* v. *Phellis*, 257 U. S. 156, on this point (p. 171):

> That the distribution reduces the intrinsic capital value of the shares by an equal amount is a normal and necessary effect of all dividend distributions—whether large or small and whether paid in money or in other divisible assets—but such reduction constitutes the dividend none the less income derived by the stockholder if it represents gains previously acquired by the corporation. Hence, a comparison of aggregate values immediately before with those immediately after the dividend is not a proper test for determining whether individual income, taxable against the stock-

holder, has been received by means of the dividend.

In the present case the value of whatever the respondents received over and above the par value of their stock "represents gains previously acquired by the National Acme Manufacturing Company." Whether there was an increase in aggregate wealth is not material.

CONCLUSION.

It is submitted in conclusion that no amount of ingenious reasoning can conceal the fact that the respondents, as a result of the sale in question, received a return in cash of their original capital interest, and in addition thereto cash and securities, the value of which constituted taxable gain severed from that capital interest. The shares of stock in the National Acme Manufacturing Company were different and separate property from the shares in The National Acme Company, and the sale of the former for the latter, plus the cash consideration, gave rise to taxable income in the amount by which the cash plus the value of The National Acme Company stock exceeded the value of the National Acme Manufacturing Company stock as of March 1, 1913, or in the case of that acquired after March 1, 1913, its cost. The tax was properly assessed and collected, and the decision below should be reversed.

JAMES M. BECK,
Solicitor General.

ALFRED A. WHEAT,
Special Assistant to the Attorney General.

MARCH, 1924.

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WM. R. STANS
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No. 262.

In the Supreme Court of the United States

OCTOBER TERM, 1923.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE,
Petitioner,

vs.

LOUIE STEARN,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

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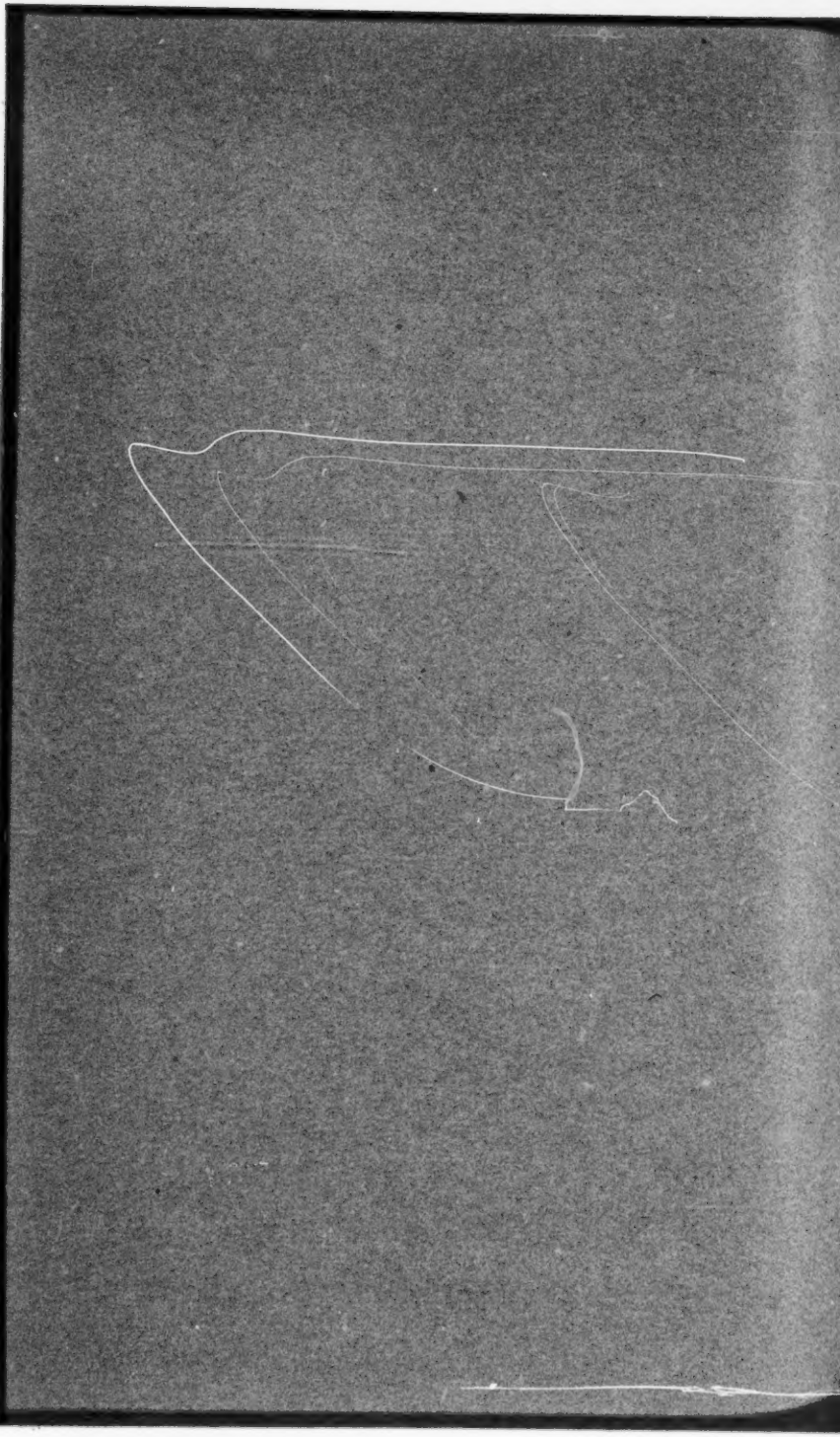

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BRIEF FOR RESPONDENT.

THE FACTS.

The case of *Weiss vs. Stearn* was submitted on an Agreed Statement of Facts printed in full on pages 11 to 13 of the record in case No. 262. The contract, which is incorporated in the Agreed Statement by reference, is printed on pages 6 to 11. The contract should be read in full, but the essential facts of the transaction are set forth concisely in the following quotation from the opinion of the Court of Appeals, Record 262, pages 33 and 34:

> "The transaction in question was had pursuant to a contract between the stockholders and Eastman, Dillon & Company, by the first paragraph of which the former apparently agreed to sell, and the latter to buy, the stock 'at and for the price of three

hundred dollars ($300) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth.' But the real transaction specifically required by the subsequent provisions of the contract and actually consummated was as follows:

The stockholders delivered all of their stock to an intermediary, the Cleveland Trust Company, in trust. For each share so deposited they were to, and later did, receive $150 cash and five shares of new stock of the nominal par value of $50 each, but actually valued at $30 per share for the purposes of the bargain, being, in the aggregate, one-half (250,000 shares) of the stock of a new corporation formed to take over the business. Eastman, Dillon & Company, in order to acquire the other half of the stock of the new corporation, paid to the trustee $7,500,000, being at the rate of $30 per share for 250,000 shares. The vendors and vendees then proceeded to organize the new corporation under the laws of the same State, Ohio, with the same powers and the same name, except for the dropping of the word 'Manufacturing.' Its capital stock, $25,000,000, was five times that of the old concern, and was divided into shares of the denomination of fifty, instead of one hundred, dollars each, as theretofore. Accordingly there were ten $50 shares of the new for each $100 share of the old stock. The new corporation issued all of its stock to the trustee in exchange for all the assets subject to the liabilities of the old company. The trustee delivered one-half (250,000) of the shares of the new stock to Eastman, Dillon & Company, in consideration of the $7,500,000 paid in, and distributed pro rata among the old stockholders, the other half, 250,000 shares, and the $7,500,000 at the agreed rate of $150 and five shares of the new for each share of the old stock. The old company was then dissolved and the new corporation continued business under the same management.

The net results, putting to one side for the moment the matter of reincorporation, were that the capital stock of the concern was increased fivefold, the face value of the shares cut in half, and that the old stockholders sold Eastman, Dillon & Company, one-half of their respective holdings at the price of $30 per share for the new stock. The income tax on such profit as was made on that half which was so sold was paid by defendants in error, who were among the old stockholders. They were, however, further compelled to pay a like tax because of the receipt of the other half of the new stock in exchange for the old, the Government claiming that they made the same gain thereby as upon the half which they had sold, and for the recovery of this they sued and had judgment below.

It is clear that *the half in question was not sold to Eastman, Dillon & Company.* This is true despite the above-quoted language of the first paragraph of the agreement, as substance must dominate form; and what was done, rather than what was agreed to be done, is the final criterion. *United States v. Phellis,* 257 U. S. at page 172. *As to this half, the legal title never went to Eastman, Dillon & Company, nor beyond the Cleveland Trust Company,* which held it for the benefit of the old stockholders, in whom the equity continued until the agreed equivalent in new stock was delivered to them and the old stock retired by the dissolution of the old corporation. Therefore, *if the transaction as to this half resulted in taxable gain at all, it was not as the consequence of any sale to Eastman, Dillon & Company, but must be looked for in the transaction had between the old stockholders, the trustee, and the corporation.*

The old corporation went through the form of an exchange of its assets for the new stock and a distribution thereof among its shareholders as upon final dissolution. There was nothing that can be

properly called a sale of the half of the stock under consideration in any aspect of the case. The question to be decided resolves itself, therefore, to this: Is there taxable income to the stockholder in the receipt of shares of greater face value and actually worth more than the cost to him of old shares for which they are exchanged upon the occasion of a reorganization accomplished by the taking down of an old corporate structure and the setting up in its place of a new one with the same powers under the laws of the same State, but having greater capital stock, with a taking over of assets subject to liabilities and a continuance of the business under the same management and name?'' (italics ours)

THE QUESTION INVOLVED.

The question involved is whether the plaintiff below actually derived a profit or income measured by the difference between the cost of his stock and Three Hundred Dollars ($300.00) per share, or whether he derived an income measured by the difference between one-half of the cost of his stock and One Hundred and Fifty Dollars ($150.00) per share.

ARGUMENT.

I. The Contract Was Not For the Sale of the Stock to Eastman, Dillon & Company at $300.00 Per Share, But Was For the Sale of a Half Interest at $150.00, and the Substitution For the Other Half Interest of Stock in Which Eastman, Dillon & Company Never Had Any Interest, Legal or Equitable. The New Stock Represented a Continuation of the Same Corporate Enterprise and the Entire Equitable Interest in the Stock Which Plaintiff Received Was At All Times Owned By Him.

The fact that one clause of the contract, pursuant to which the exchange of the stock was made, recited that stockholders in the old company agree to sell their stock "for $300.00 per share, payable one-half in cash and one-half in securities, as hereinafter set forth," did not make the transaction the equivalent of a sale for cash. This is so apparent from the terms of the contract itself that we only discuss the question at all because the presence of the words "for $300.00 per share" was apparently the original basis of the ruling of the Revenue Department that the transaction was taxable as a sale. The first paragraph of the opinion of the Treasury Department in this case was:

> "That *inasmuch as a selling price or exchange value of $300.00* was placed upon each share of the National Acme Manufacturing Company's stock at the time it was sold or exchanged for five shares of stock in the National Acme Company priced or valued at $30.00 a share and $150.00 in cash, the transaction must be regarded for Federal income tax purposes, as the *sale of the stock* of the National Acme Manufacturing Company." (italics ours)

To hold that the transaction was a sale for $300.00 per share, is to ignore the words immediately following, "payable one-half in cash and *one-half in securities, as hereinafter set forth.*" The stockholders who deposited their stock under this contract *had no option to get $300.00 in cash.* The only thing they were entitled to, and the only thing they got was $150.00 for the half interest which they sold to Eastman, Dillon & Company, and five shares of new stock for the other half interest.

But, as pointed out in the Statement of Facts and in the quotation there made from the opinion below, the new stock received by the old stockholders was never owned by Eastman, Dillon & Company. The contract was of a dual nature, being in part a contract for the sale of a half interest to Eastman, Dillon & Company, and in part a reorganization agreement between the old stockholders and Eastman, Dillon & Company, providing for the creation by the vendors and purchasers of a new company to stand in the place of the old, and for the distribution by the trustee of the stock of the new company to the old stockholders and to Eastman, Dillon & Company, in proportion to their respective interests, as fixed by the trust agreement.

The brief of the Solicitor General asserts that: "The transaction between the respondents and Eastman, Dillon & Company was in fact and legal effect *a sale by the respondents of all their stock.*" But the very section of the brief which is devoted to establishing this point makes an admission which is fatal to his case and which demonstrates that the analysis of the transaction by the Circuit Court of Appeals quoted in our Statement of Facts is correct. He says:

*"Of course it is apparent that the purpose of Eastman, Dillon & Company, the purchasers, was to become the owners of a half interest in a very profitable business. * * * "*

This *was* their purpose.

Likewise it was the purpose of the old stockholders to sell a half interest in the business.

The transaction as carried out resulted in the sale of such half interest and the continuance of the same business. When the stock of the old company was deposited with the Trustee and Eastman, Dillon & Company had deposited $750,000 with the Trustee, Eastman, Dillon & Company became the owners of one-half the stock in the old company and the old stockholders retained the other half interest. The new stock was distributed by the Trustee, one-half to Eastman, Dillon & Company, and one-half to the old stockholders, and the respective interests of the stockholders in the new company were therefore exactly the same as their respective interests in the old company at the time the actual exchange of old stock for new took place.

The contention on behalf of the Revenue Department seems to be that although they concede that the purpose of the purchaser was to become the owner of a half interest in a business, and though that is all that was accomplished by the transaction as carried out, nevertheless plaintiff's tax is to be figured as if Eastman, Dillon & Company had intended to buy and had actually bought the entire business. This contention is obviously founded solely on the phraseology of portions of the contract and not on the substance and effect of the transaction.

II. Plaintiff Realized No Income From the Receipt of Stock in The National Acme Company, Since His Capital Interest in the Same Single Corporate Enterprise Continued Without Any Change in the Nature Of His Investment.

The District Judge and the three judges of the Circuit Court of Appeals reached the conclusion that no taxable income had been realized from the exchange of stock on the grounds; first, that in determining whether taxable income was realized, the substance and result of the transaction, rather than the form, must control; second, that the result of the transaction was that plaintiff retained one-half of his capital investment represented by stock, which was in substance the same as that represented by one-half of his original stock, and that he was therefore taxable only on the profit represented by the excess of the cash received over the cost of the one-half interest which he had disposed of.

This Court has repeatedly held, in construing the various income tax laws, that the determination of the question whether taxable income has been derived as the result of a particular transaction depends upon the substance of the transaction, and not upon its form.

In *Eisner vs. Macomber*, 252 U. S., at page 206, the court said:

> "In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income,' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form."

In *United States vs. Phellis*, 257 U. S. 156, at page 168, the court said:

> "We recognize the importance of regarding matters of substance and disregarding forms in applying the provisions of the Sixteenth Amendment and income tax laws enacted thereunder." (Citing *Lynch vs. Turrish*, 247 U. S. 221; *Southern Pacific vs. Lowe*, 247 U. S. 330; *Gulf Oil Co. vs. Lewellyn*, 248 U. S. 71.)

In *Eisner vs. Macomber*, the court said:

> "The fundamental relation of capital to income has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop." (252 U. S. 206.)

Applying this simile to the facts of the present case, it is clear that prior to the reorganization the capital of the owner of a share of stock in The National Acme Manufacturing Company was such share of stock. It represented plaintiff's interest as a stockholder in a single corporate enterprise. This was the tree. One-half of such interest was sold for cash, was thus severed from the tree, and taxable income resulted from such severance. But for the other half such owner received five shares of stock in The National Acme Company, which represented exactly the same proportionate interest in the same single corporate enterprise. The five shares received in exchange continued to be, in everything except name, the same tree. The tree has borne nothing different from itself, nothing which is separated from itself, nothing which can be compared to fruit. It is in every substantial respect the same tree which it was before. It has merely changed its name.

We can carry the simile of the tree a step further and say that the tree has five branches where it had one

before, but each of those branches is a part of the tree itself. When the owner sells a share of his new stock, he cuts off one of the branches, and a realization of taxable income results.

Again in the *Phellis* case, the court said:

> "The liability of a stockholder to pay an individual income tax must be tested by the effect of the transaction upon the individual." (page 174)

If, by putting the transaction which it is claimed resulted in income in this case, in another form, plaintiff could have received exactly the same stock and cash as a result of the completed transaction, without having received income, as defined in *Eisner vs. Macomber*, 252 U. S. 189, it is clear that in truth and in substance no income has been realized by plaintiff. In other words, "the effect of the transaction upon the individual" is the same, whether he arrives at a designated point by one route or by another.

III.

The Same Result Could Have Been Attained by a Process of Internal Reorganization, and if This Manner of Procedure Had Been Adopted, No Taxable Income Would Have Resulted.

Assuming that the axiom that, "Things which are equal to the same thing are equal to each other," holds good in law, as in mathematics, it can be proved with the certainty of a geometrical demonstration that the transaction between the stockholders of The National Acme Manufacturing Company and Eastman, Dillon & Company could have been carried through in a manner which would have reached identically the same result without resulting in taxable income. The demonstration

is simple. The stockholders in The National Acme Manufacturing Company could have amended its Articles of Incorporation providing for the increase of the capital stock to Twenty-five Million Dollars, the reduction of the face value of its shares to Fifty Dollars and the change of name to "The National Acme Company." They could have caused the declaration of a stock dividend, as the result of which each stockholder in The National Acme Manufacturing Company would have held ten shares of stock in The National Acme Company, of the par value of Fifty Dollars each. Each stockholder could then have sold one-half of his stock to Eastman, Dillon & Company for Thirty Dollars per share. As a result of the transaction carried out in this manner, no income would have accrued from the stock dividend. Plaintiff would have been taxable only on the profit derived from the sale of one-half his stock for cash, and he would have had, after such sale, the same identical stock and the same amount of cash which he had as the result of the actual transaction. See Opinion of Circuit Court of Appeals, Rec. 262, bottom page 35 and top page 36.

This method of reasoning out the real substantial *result* of the transaction by assuming a different corporate process, and ascertaining whether taxable income would have resulted from the assumed process, is the same adopted by this Court in the *Cullinan* case, where the court says, 262 U. S., at page 137:

> "If the trustees in liquidation had sold all the assets for $6,000,000 in cash, and had distributed all of that, no one would question that the late stockholders of Farmers' Petroleum Company would, in the aggregate, have received a gain of $5,900,000, taxable as income. The *result* would obviously have been the same, if the trustees had taken in payment,

and distributed, bonds of the value of $6,000,000, in some new corporations. And the *result* must also be the same where that taken in payment is $3,000,000 of such bonds and $3,000,000 in stock of a third corporation." (Italics ours)

The only difference between the result of the hypothetical transaction and the result of the actual transaction is that in the one case there would have been no change in the corporate entity, while in the other there has been a technical change in corporate entity. But nothing could be more shadowy and utterly lacking in substance than this difference in corporate entity, in view of the fact that the new corporation is incorporated under the laws of the same state, with the same assets, powers, purposes and officers as the old.

The conclusion seems to us irresistible that no income has in fact been realized by the receipt of the new stock, and that the Government's attempt to tax alleged income from such transaction is based upon the form of the transaction, and not on its substance.

IV.

The Mere Difference in Corporate Entity Between The National Acme Manufacturing Company and The National Acme Company is Not a Sufficient Basis for Holding That Income Was Realized by the Exchange of One Stock for the Other.

As pointed out in the opinion of the Circuit Court of Appeals, this Court has held that:

> "Where a corporate entity has been found to be a mere matter of form, it has been disregarded in similar transactions in respect to income taxation. *Southern Pacific Co. vs. Lowe*, 247 U. S. 330; *Gulf Oil Co. vs. Lewellyn*, 248 U. S. 71; *Alpha Portland*

Cement Co. vs. United States, 251 Fed. 339; although it is not so when it is a matter of substance, *Eisner vs. Macomber* and *United States vs. Phellis, supra.*" (285 Fed. 689-692)

In *Southern Pacific Co. vs. Lowe*, in which the Southern Pacific Company, a Kentucky corporation, was held not to be taxable on income received from The Central Pacific Company, a Utah corporation, out of profits accumulated by the Utah company before March 1, 1913, the court says:

> "We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing 'the entire net income arising or accruing from all sources' during each year commencing with the first day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control. And, besides, the funds represented by the dividends were in the actual possession and control of the Southern Pacific as well before as after the declaration of the dividends." (247 U. S. p. 337)

In like manner we must assume that it was the purpose and intent of Congress to refrain from taxing as income derived from a transaction the mere increase in capital value of an investment which after such trans-

action remains in truth and in substance the same investment as before.

After Eastman, Dillon & Company acquired a one-half interest in the stock of The National Acme Manufacturing Company by depositing the cash consideration therefor, Eastman, Dillon & Company and the other stockholders of The National Acme Manufacturing Company were to unite in forming a new corporation and in causing the old company to transfer its assets to the new (Article 4 of contract, page 8). The new company was therefore a mere agency of the stockholders of the old company and subject in all things to their proper direction and control. The principle of *Southern Pacific Co. vs. Lowe* is therefore directly applicable.

The same conclusion was reached in *Gulf Oil Co. vs. Lewellyn*, 248 U. S. 71, although in that case the company which received the dividends did not itself do the business of its subsidiaries, nor have actual possession of their property, as in *Southern Pacific Co. vs. Lowe*. The court said at page 72:

> "It is true that the petitioner and its subsidiaries were distinct beings in contemplation of law, but the fact that they were related *as parts of one enterprise, all owned by the petitioner*, that the debts were all enterprise debts due to members, and that the dividends represented earnings that had been made in former years and that practically had been converted into capital, unite to convince us that the transaction should be regarded as bookkeeping rather than as 'dividends declared and paid in the ordinary course by a corporation.'" (italics ours) (248 U. S. 72)

In the two cases last cited there was a more substantial change in the form of the investment of the

company which received the dividends than there was in the form of plaintiff's investment.

In the case of *Southern Pacific Co. vs. Lowe,* the apparent surplus of the Central Pacific Company was reduced and the aparent indebtedness of the Southern Pacific Company to the Central Pacific Company was reduced by precisely the amount of the dividends.

In the present case plaintiff merely received different certificates of stock which represented exactly the same proportionate interest in a corporation having the same stockholders, the same assets, powers, purposes and management as the original company. The ultimate facts are well summarized in a single brief paragraph of the opinion of the Court of Appeals.

> "In the present case there has been no attempt on the part of the concern to segregate or distribute its surplus, but merely a reorganization accompanied by a stock dividend. It has not been divided into two corporations, one to hold the capital, the other to take the earnings, as in the cited cases. The old charter was surrendered when the new one was taken. The venture of the stockholder in the hazard of the business continues undivided. He has not drawn out his profit. His investment is still entirely in the same enterprise, albeit represented by new certificates, yet essentially the same." (285 Fed. 689-692.)

We submit that the *ratio decidendi* of *Southern Pacific vs. Lowe* and *Gulf Oil Company vs. Lewellyn* was that the relation of the taxed corporation to the assets out of which income was alleged to have been realized remained in substance the same; it had the same ownership, direction and control over these assets in substance, but not in *form,* after the alleged transaction as it had before. So the taxed individual in this case,

prior to the transaction, had merely the ownership, direction and control incident to holding stock in an Ohio corporation, which stock represented a certain fractional interest in such assets. After the transaction, he had the same identical ownership, direction and control over such assets as he had before, being still the owner of stock in an Ohio corporation, identical except in name, which stock represented the same fractional interest in the same corporate enterprise as before.

V.

The Rule of Construction Announced in Previous Decisions Prevents a Holding That Income Was Realized by the Transaction in the Case at Bar.

In *Gould vs. Gould*, 245 U. S. 151, at 153, this Court held that the income tax law, like other taxation laws, is, in case of doubt, to be construed most strongly against the Government. That is the judicial rule of construction, but this Court is thoroughly conversant with the fact that the executive rule of construction—the rule adopted by the Treasury Department—is exactly contrary to the judicial rule, and in case of doubt as to whether income has been realized from a transaction, such doubt is always resolved by the Treasury Department in favor of the Government. Therefore, rulings by Treasury Department officials themselves, that no income is realized by transactions essentially similar to the one at bar, evidence that in the judgment of the Treasury Department the question is not even doubtful.

We submit that the fact that the Treasury Department has twice ruled that similar transactions did not result in income, and that the District Judge and the

three judges of the Circuit Court of Appeals who have passed on the facts of the instant case are of the opinion that no income was realizeed, should be persuasive in this Court that the question whether income was realized is at least doubtful, and that therefore, applying the judicial rule of construction, no taxable income was realized.

The first ruling of the Treasury Department above referred to is that of Commissioner W. H. Osborn, May 3, 1915, reported in Corporation Income Tax Service 1916, Paragraph 1779, and is as follows:

> "This office is in receipt of your letter of the 21st *ultimo*, amended by your letter of the 23rd, in which is presented the following proposition for ruling of this office:
>
> > 'A corporation having a capital stock of $500,000 has accumulated a surplus of $500,000 in addition to paying handsome dividends upon its capital stock. This company proposes to sell, or rather transfer to a reorganized company in which the stockholders and their proportionate interests are the same, all of its assets and good will for $5,000,000 par value of the second company's capital stock. The good will involved in the above proposition has been created entirely by the first company, and the earning capacity of the first company would appear to justify the suggested transaction.'
>
> * * * In the case cited the $5,000,000 capital stock issued in payment for the assets (tangible and intangible) of the first company is in fact of no greater actual value than is that of the $500,000 of the first company, for the reason that in each case the value of the stock is based upon and supported by the same assets, and until the stock issued by the purchasing or reorganized company in payment for

> the assets of the first company is converted into cash or its equivalent, no taxable income will have been realized from the transaction. In other words the excess of the nominal par value of the stock issued in payment for assets, over the nominal par value of the stock of the selling company, the stock in both cases being supported by the same assets, does not constitute income within the meaning of the Federal income tax law."

This ruling was subsequently reversed by the Treasury Department to conform to TD-2274, holding that stock dividends were taxable income (Corporation Income Tax Service 1917, Par. 1217), but TD-2274 was itself held erroneous in *Eisner vs. Macomber*, 252 U. S. 189.

Even after TD-2274 was in force, the revenue officials held that the sale to a new corporation of the assets of an old company for stock in the new company of *equal par value*, distributed share for share to stockholders of the old company, did not constitute taxable income although the stock was worth double its par value. This opinion, reported Corporation Income Tax Service 1917, Sections 2119, 2121, says in part:

> "The stock, both authorized and issued, being in both cases of like par value and being predicated upon exactly the same assets, the transaction constitutes a deal by which the second company takes over the assets of the first company, giving therefor its stock of a par value exactly equal to the par value of the stock of the first company outstanding, thus placing in the hands of the stockholders the same number of shares of the second company and same par value as that which they theretofore held in the first company, the stock in both cases being supported by the same assets. Hence the transaction resulted in no gains, profits or income to either the

first corporation or its stockholders. If, as you say, the stock of the first company at the time of this transaction, was worth 'double par', the stock of the second company being supported by identically the same assets, is presumably of the same value and the exchange of the new stock for the old, results in no income subject to tax. It is simply an exchange of assets of like character and like value."

It clearly appears from these rulings that the Revenue Department officials, after considering and reconsidering the matter, did not consider that *mere change in corporate entity,* constituted a realization of income. The distinction between the case considered in this ruling and the case at bar, i. e., the identity of the par value of the stock received with that surrendered, is of no importance since the decision in *Eisner vs. Macomber.*

We believe these decisions justify the inference that neither the legislators who passed the law nor the officials charged with enforcing it, nor the public taxed by it, regarded stock received in a reorganization, representing the same business and assets, as taxable income.

In the *Macomber* case, in considering the meaning of the word "income" in the Sixteenth Amendment, the court said that it required only "a definition of the term 'income' as used in common speech, in order to determine its meaning in the amendment." (252 U. S. 206-7.)

When the court said in the *Hornby* case "dividends are the appropriate fruit of stock ownership, *are commonly reckoned as income* and are *expended as such by the stockholder,* without regard to whether they are declared from most recent earnings or from a surplus accumulated from the earnings of the past, or are based upon the increased value of the property of the corporation," it was phrasing in different language the same

thought expressed in the *Turrish* case, where it deprecates fine spun legal and economic distinctions in the interpretation of a "statute which concerns the activities of men, and intended, it might be supposed, to be without perplexities and readily solvable by the offhand conceptions of those to whom it was addressed."

The above quotations all express the thought that if a transaction does not result in income, *as the word is generally understood,* it does not result in income taxable under the constitutional amendment. The decisions of the Treasury Department above quoted, and the decisions of the four judges who considered the case, indicate that the transaction in the case at bar did not result in income, as that word is generally understood.

In attempting to reach a conclusion as to what certain language means to people in general, when such a question cannot be satisfactorily resolved by reference to dictionaries, the first test applied by an investigator is,—What does such language mean to me as applied to a transaction by me? If I had an investment in the common stock of a corporation and the corporation transferred its business, assets and liabilities, as a going concern, to another corporation formed for the purpose, which had no other business, assets or liabilities, such transfer being pursuant to a contract between myself and other stockholders that we would accept common stock in the new company in exchange for our old stock, and that the business would be carried on by the new company under the old management, would I consider that I had changed my *capital investment,* or that I had *realized* a profit? We believe there can be but one answer to these questions.

If, as a part of a single transaction, I sold half of my stock interest for cash, and took stock in a new com-

pany formed as aforesaid, in exchange for the other half interest, the answer must be the same as to the half interest exchanged for stock. If the new corporation was formed under the laws of the same state, and with the same powers as the old, so that the same result could have been attained by a mere process of internal reorganization, and if it was already settled law that the result arrived at in that manner would not result in income, would I not be doubly justified in my conclusion?

We believe that in the consideration of this case each judge must ask himself these questions, and that all must come to the same conclusion.

VI.

The Cases Relied On by the Government Are Not Applicable to the Facts of the Present Case.

The Solicitor General relies principally upon the case of *United States vs. Phellis*, 257 U. S. 156. The decision in this case was rendered before the decision in the case at bar in the District Court, and was fully considered and distinguished both by that court and the Court of Appeals. Referring to the *Phellis* case, the Circuit Court of Appeals said, at Page 692:

> "The latter case, strongly relied upon by plaintiff in error, does not present a parallel situation. There the surplus had been separated from the capital for the purpose of distributing it among the stockholders in the form of the stock of a new corporation to which the assets were conveyed. But the old corporation continued to exist, its stock remained outstanding, and the segregation of capital from surplus was accomplished by setting over to it assets equal to its capital stock and capable of returning future dividends to its stockholders."

We regard it as most significant that this Court, in the recent case of *Cullinan vs. Walker*, 262 U. S. 134, decided April 30, 1923, dealing with the distribution of stock of a Delaware holding company, for stock in a producing and pipe line company, expressly mentioned as the "*material elements*" which distinguished the facts of the *Phellis* case from the facts in *Eisner vs. Macomber*, two points of distinction which clearly distinguish the case at bar from the *Phellis* case. The court said:

> "All the material elements which differentiate the *Phellis* and *Rockefeller* cases from *Eisner vs. Macomber* are present also here. The corporation whose stock the Trustees distributed was a *holding company*. In this respect it differed from Farmers Petroleum Company which was a producing and pipe line company. It differed from the latter also because it was *organized under the laws of another state.*" (Italics ours) 137.

In the case at bar none of the aforesaid material elements which differentiate the *Phellis* and *Rockefeller* cases from *Eisner vs. Macomber* are present. The National Acme Company, whose stock was received in exchange, was not a holding company, but an operating company, with the same powers and purposes, management and assets as the original company. It was formed under the laws of the same state, and the ultimate result of the transaction was identically the same as if there had been no change in the corporate entity.

In addition to the two points of distinction stressed as material in the *Cullinan* case, there are other important distinctions between the facts in the present case and the facts upon which the court based its judgment in the *Phellis* case.

In the *Phellis* case this Court stated:

> "Each holder of the New Jersey company's common stock, (including claimant), *retained his old stock*, and besides received a dividend of two shares for one in stock of the Delaware company, and the New Jersey company *retained in its treasury six per cent. debenture stock of the Delaware company* equivalent to the par value of its own outstanding common stock." (Italics ours) 257 U. S. 156, at p. 167.

In the present case the stockholders did not retain heir stock in the old company, and the old company re-ained nothing in its treasury.

In the *Phellis* case this Court said:

> "After the reorganization and distribution of the stock of the Delaware company the New Jersey company continued as a going concern and still exists." (page 167)

In the present case the old corporation was dis-olved.

While we do not believe that the case of *Marr vs. nited States*, cited on page 20 of Petitioner's brief, was orrectly decided, the facts of that case are essentially fferent from this, since the new corporation was in-rporated under the laws of a different state, with dif-ent powers, and had additional assets. The result at-ined by the exchange in the *Marr* case could not have en attained by a mere process of internal reorganiza-on, stock dividend, and sale of half the increased stock. hat judgment could be affirmed without putting this ourt in the position of holding that the existence of xable income depends, not upon the result of the trans-tion, but upon the manner in which it is carried out. See *supra* Subdivision III)

The Petitioner also relies upon and quotes from the case of *Osgood vs. Tax Commissioner,* 235 Mass. 88. In the sentence immediately following the quotation from the *Osgood* case in Petitioner's brief, page 23, the court cited *Tax Commissioners vs. Putnam,* 227 Mass. 522, as the basis for its holding that a profit had been realized. The *Putnam* case held that stock dividends were taxable as a realization of income. Having held that a mere multiplication of shares through a stock dividend constituted taxable income, the court naturally held that a multiplication of shares through a reorganization likewise constituted a realization of income. But the *Putnam* case was disapproved by this Court in *Eisner vs. Macomber,* and the *Osgood* case is therefore of no weight in this jurisdiction. It appears, further, that in that case the plaintiff had exchanged common *and preferred* stock for common stock in the new company.

The facts of the present case are different from those in any case heretofore decided by this Court. In substance the case is essentially similar to *Eisner vs. Macomber,* and the principles announced in that case should govern the decision in this. It is essentially different from the *Phellis, Rockefeller* and *Cullinan* cases in that there was an unbroken continuance of the same corporate enterprise by a single corporation of the same state, without segregation of capital and surplus, without segregation of different branches of the business to separate corporations, and without changing the form of the stockholders' investment from common stock in the operating company to any other form of security.

Since the ultimate result of the transaction could have been reached without any change in corporate entity, and since the new company is an operating company, formed under the laws of the same state and with

the same powers and purposes as the old company, and since the stockholders' interest in the capital of the company continues to be represented by stock in the operating company in no manner different from the change which would have resulted from an amendment of the Articles and a non-taxable stock dividend, we submit that this Court cannot hold that taxable income resulted from the exchange of securities, without abandoning the fundamental principle that the existence of taxable income must be determined "according to truth and substance, without regard to form."

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AMOS BURT THOMPSON,
CHARLES P. HINE,
Of Counsel.

In the Supreme Court of the United States.

OCTOBER TERM, 1922.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, petitioner,
v.
JOHN G. WHITE, RESPONDENT. } No. —.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

The Solicitor General, on behalf of Harry H. Weiss, Collector of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit rendered in the above-entitled case on January 9, 1923, affirming a judgment entered by the District Court allowing the respondent to recover taxes paid under protest.

STATEMENT.

This is an action brought by the respondent to recover taxes assessed and paid to the Government, under protest, by virtue of the Revenue Law of 1916 (39 Stat. 757), upon shares of stock received in the National Acme Company growing out of an apparent

sale and termination of the National Acme Manufacturing Company.

This case was tried in the District Court and resulted in judgment for the respondent. The Circuit Court of Appeals, taking the view that the transaction was merely a reorganization accompanied by a stock dividend, affirmed the judgment. Petitioner now seeks to have this judgment of the Circuit Court of Appeals affirming the judgment of the District Court reviewed by certiorari.

QUESTION INVOLVED.

The sole question involved is whether the respondent should be regarded for the purpose of income taxation under the Revenue Law of 1916 (39 Stat. 757) as having disposed of, with profit, only one-half of his respective holdings in the National Acme Manufacturing Company, or whether he should have been considered as having so disposed of the entirety.

THE FACTS.

Under a contract between the stockholders of the National Acme Manufacturing Company and Eastman, Dillon & Company, the stockholders sold all of the stock in the National Acme Manufacturing Company to the latter company and received for each share of the old stock $150 in cash and five shares in a newly organized "National Acme Company." Eastman, Dillon & Company, by virtue of this transaction, acquired a one-half interest in the newly organized company.

The petitioner contends that the profit was the difference between the March 1, 1913, value of the stock of the old National Acme Manufacturing Company and the entire consideration received in exchange therefor, consisting of cash and stock of the new National Acme Company.

REASONS FOR GRANTING THE PETITION.

1. The decision of the Circuit Court of Appeals is detrimental to the interests of the Government in the collection of revenue under the Revenue Law of 1916, as it is directly opposite to the ruling of the Treasury Department in pursuance of which large amounts of taxes have already been collected. If the decision stands, numerous other suits may be expected, with strong possibility of conflicting decisions in other circuits.

2. The question is of grave importance to the administration of the Internal Revenue Laws, which this decision leaves in great confusion.

3. The Circuit Court of Appeals erred in holding that the distribution upon reorganization of the new stock in exchange for the old did not involve taxable income.

JAMES M. BECK,
Solicitor General.

BRIEF IN SUPPORT OF THE PETITION.

I.

The court erred in holding that while as to one half of the stock in the National Acme Manufacturing Company there was a sale from which the stockholders derived taxable income, yet as to the other half of the stock there was an exchange of stock for stock out of which exchange the old stockholders of the National Acme Manufacturing Company received no taxable income, but only a stock dividend.

The stockholders sold their shares in the National Acme Manufacturing Company for $150 cash and five (5) shares of stock in the new company for each share of stock in the old, the assets of the old company, including surplus, having been transferred to the new company. Certainly the undivided interest of the individual stockholder in the surplus accumulated had been released to and drawn by him as profit or income from his original capital investment. The distribution in stock to the stockholders of the National Acme Manufacturing Company resulted in taxable income regardless of the fact that this company was dissolved and never continued as a going concern after said distribution. The distribution in the present case can not be said to be a stock dividend, for in *Eisner* v. *Macomber*, 252 U. S. 189, 202, 203, it is stated that the essentials of a true stock dividend are that "a stock dividend really takes nothing from

the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. * * * The proportional interest of each shareholder remains the same."

In the present case the transaction was a sale of all of the stock of the National Acme Manufacturing Company and, while the corporate assets may have been the same upon its completion as they were at its inception, it is certainly not true that stockholding interests were identical. It is believed that this question has been conclusively settled by the case of *United States* v. *Phellis*, 257 U. S. 156, wherein it was held that the distribution constituted a property dividend and was taxable as such in the hands of the stockholders. The court pointed out (p. 169) that—

> Hence the inquiry must be whether the shares of stock in the new company received by claimant as a dividend by reason of his ownership of stock in the old company constituted (to apply the tests laid down in *Eisner* v. *Macomber*, 252 U. S. 189, 207), a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested, and coming in, that is, received or drawn by the claimant for his separate use, benefit and disposal.

The distribution in question surely resulted in taxable income to the stockholders of the old company in the form of profit derived from the sale and exchange of their shares of stock in the National Acme Manufacturing Company for shares of stock in the National Acme Company and cash. The measure of the profit, gain, and income so derived is the difference between the fair market value of the stock of the National Acme Manufacturing Company on March 1, 1913, and the value of the entire consideration received in payment thereof, i. e., five shares of stock of the National Acme Company and $150 in cash for each share of stock of the National Acme Manufacturing Company.

Merchants Loan & Trust Company v. *Smietanka*, 255 U. S. 509.
Goodrich v. *Edwards*, 255 U. S. 527.
Walsh v. *Brewster*, 255 U. S. 536.

CONCLUSION.

It is respectfully submitted that a writ of certiorari should issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit to the end that it may be reversed.

JAMES M. BECK,
Solicitor General.

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

JOHN C. HAYES,
Special Assistant to the Attorney General.

APRIL, 1923.

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TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1923.

No. 263.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

JOHN G. WHITE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

PETITION FOR CERTIORARI FILED MARCH 26, 1923.
CERTIORARI AND RETURN FILED JULY 5, 1923.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1923.

No. 263.

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1 [Caption omitted in printing.]

2 UNITED STATES OF AMERICA,
Northern District of Ohio, Eastern Division, ss.:

In the District Court of the United States, for the Northen District of Ohio, Eastern Division.

No. 10430.

JOHN G. WHITE, PLAINTIFF,

against

HARRY H. WEISS, COLLECTOR OF UNITED STATES INTERNAL REVENUE for the Eighteenth District of the State of Ohio, defendant.

Amended Petition for Money only.

Filed April 24, 1920.

The plaintiff, John G. White, by White, Johnson, Cannon and Spieth, his attorneys, complains of the defendant, Harry H. Weiss, Collector of United States Internal Revenue for the Eighteenth District of the State of Ohio, for that—

At all the times hereinafter mentioned, plaintiff was and now is a citizen of the State of Ohio, and a resident of the Eighteenth Internal Revenue District of the State of Ohio.

At all the times hereinafter mentioned, the defendant was, and now is, the collector of United States internal revenue for the Eighteenth District of the State of Ohio.

The National Acme Manufacturing Company was, during the year 1916, a corporation organized and existing under and by virtue of the laws of the State of Ohio.

On the 15th day of March, A. D. 1916, said corporation had outstanding capital stock in the amount of four million dollars ($4,000,000.00), divided into one million five hundred thousand dollars ($1,500,000.00) of preferred stock and two million five hundred thousand dollars ($2,500,000.00) common stock, each share being of the nominal or par value of one hundred dollars ($100.00) each. At said date the book value of the assets of said company, excluding liabilities other than capital stock and surplus, amounted to
3 more than six million six hundred and ninety thousand dollars ($6,690,000.00), the excess of said assets over the par value of its capital stock representing profits of the corporation which had been earned prior to that date and invested by the company in its business.

On the 15th day of March, A. D. 1916, a stock dividend of 100 per cent was declared by said corporation, payable to common stockholders of record on March 21, A. D. 1916. In accordance with

said declaration the officers of said The National Acme Manufacturing Company transferred from its surplus account to capital stock account the sum of two million five hundred thousand dollars ($2,500,000.00), and issued to the common stockholders of record of the said company on March 21, 1916, additional shares of stock in the proportion of one share of new common stock for each share of old common stock held by each common stockholder on that date. On that date plaintiff was the owner and holder of certificates of the common capital stock of said The National Acme Manufacturing Company, in the amount of thirty-three thousand dollars ($33,000.00) par value, and there was issued to him, in accordance with said resolution, additional shares of common stock in said company to the amount of the nominal or par value of thirty-three thousand dollars ($33,000.00). Because of the increase in the number of parts in which the ownership of the assets of the corporation, as represented by its common capital stock, was divided, the asset or book value of each share of common stock representing an equal aliquot part in the total assets of said company was proportionately decreased; the number of shares owned by each stockholder was increased by one hundred per cent (100%), and, at the same time the book value of each common share was correspondingly decreased, that is to say, that for the month prior to the closing of the books of said readjustment of the capital, on the 21st day of March, 1916, the book value of each share of the company's common stock was twice that of each share of the common stock after said one hundred per cent (100%) dividend had been declared, so that the book value of the common capital stock owned by each stockholder, including therein this plaintiff, was substantially unchanged, by reason of the said stock dividend and receipt of said certificates for said additional shares of common stock. In other words, the same interest or ownership by plaintiff in the property of said corporation was evidenced after said stock dividend by certificates for twice as many shares as before.

4 On the 8th day of November, A. D. 1916, the National Acme Manufacturing Company's said preferred stock had been called in and arrangements made for its liquidation, and its issued common stock was five million dollars ($5,000,000.00); its assets, excluding good will and patents, were at least ten million dollars ($10,000,000.00). Thus, the tangible assets made the stock worth at least two hundred dollars ($200.00) a share. On that day the officials and stockholders of said The National Acme Manufacturing Company made an agreement with Eastman, Dillon & Company, a copy of which is attached hereto, marked "Exhibit A" and made a part hereof, by which the officers and stockholders of The National Acme Manufacturing Company and said Eastman, Dillon & Company agreed to organize a new corporation under the laws of the State of Ohio, named The National Acme Company, having an authorized capital stock of twenty-five million dollars ($25,000,000.00) divided into five hundred thousand (500,000) shares of the par value of fifty

dollars ($50.00) a share, to take over all the assets and liabilities of the National Acme Manufacturing Company; that said Eastman, Dillon & Company were to pay the stockholders of the National Acme Manufacturing Company seven million five hundred thousand dollars ($7,500,000.00) in cash for half of their stock, and the new company was to issue to the old stockholders of the National Acme Manufacturing Company two hundred and fifty thousand (250,000) shares of the National Acme Company stock of the par value of fifty dollars ($50.00) a share for their stock, and to said Eastman, Dillon & Company two hundred and fifty thousand (250,000) shares of the same par value for their stock. The certificates of stock of the National Acme Company were not to be delivered to the stockholders of the National Acme Manufacturing Company until the 1st day of May, A. D. 1917. This agreement was carried out. All of the stockholders of the National Acme Manufacturing Company deposited their stock under said agreement at the time limited in said agreement. The National Acme Company was incorporated, the money was paid, and its stock issued and delivered in accordance with said agreement. On the same basis on which the stock of the National Acme Manufacturing Company was worth two hundred dollars ($200.00) a share, the book value of the stock of the National Acme Company was only twenty dollars ($20.00) per share, or forty dollars ($40.00) per one hundred dollars ($100.00) par value, but whatever the value of the stock, the National Acme Company had exactly the same property, neither more nor less than had the National Acme Manufacturing Company, and whatever the value of the assets as they were now represented by twenty-five million dollars ($25,000,000.00) of stock of the National Acme Company the same assets had theretofore been represented by five million dollars ($5,000,000.00) of stock of the National Acme Manufacturing Company, and stock of the nominal or par value of one hundred dollars ($100.00) of the National Acme Company represented ownership of only two-fifths (2/5) of the same assets represented by the corresponding nominal or par value of the stock of the National Acme Manufacturing Company. Thus, what the stockholders of the National Acme Manufacturing Company actually got was seven million five hundred thousand dollars ($7,500,000.00) in cash, and stock of the National Acme Company representing ownership of exactly the same assets as their previous stock in the National Acme Manufacturing Company.

Applying these facts to the plaintiff's case, on the 21st of March, A. D. 1916, plaintiff was the owner of certificates of the par value of thirty-three thousand five hundred dollars ($33,500.00) of stock in the National Acme Manufacturing Company, and the addition of an one hundred per cent (100%) stock dividend gave plaintiff certificates for sixty-seven thousand dollars ($67,000.00) par value of stock. For this sixty-seven thousand dollars ($67,000.00) plaintiff received one hundred thousand five hundred dollars ($100,500.00) cash from Eastman, Dillon and Company, and from the National

Acme Company certificates for one hundred and sixty-seven thousand five hundred dollars ($167,500.00) of the par value of the stock of the National Acme Company, evidencing his ownership of one hundred and sixty-seven thousand five hundred twenty-five millionths ($\frac{167,500}{25,000,000}$) of exactly the same property of which he had theretofore owned sixty-seven thousand five-millionths ($\frac{67,000}{5,000,000}$). No new property or funds went into the new company. The twenty-five million dollars ($25,000,000.00) of stock represented neither
6 more nor less property than five million dollars ($5,000,000.00) of stock of the National Acme Manufacturing Company. The certificates for one hundred and sixty-seven thousand five hundred dollars ($167,500.00) of stock which plaintiff got in the new company evidenced his ownership of only half of the identical assets evidenced by the certificates for sixty-seven thousand dollars ($67,000.00) of stock which plaintiff held in the old company, and all that plaintiff got by the transactions during 1916 in said The National Acme Manufacturing Company and the National Acme Company in the way of income was two-thirds of the amount of cash which plaintiff received, being two-thirds of one hundred thousand five hundred dollars ($100,500.00). Before the declaration of the stock dividend, the plaintiff's interest in the assets of the National Acme Manufacturing Company was thirty-three thousand five hundred five-millionths ($\frac{33,500}{5,000,000}$). After the stock dividend, plaintiff's interest in said assets was sixty-seven thousand ten-millionths ($\frac{67,000}{10,000,000}$), which is exactly the same. After the reorganization into the National Acme Company, plaintiff had one hundred and sixty-seven thousand five hundred twenty-five millionths ($\frac{167,500}{25,000,000}$), which, when both numerator and denominator is divided by five (5), leaves thirty-three thousand five hundred five-millionths ($\frac{33,500}{5,000,000}$), or sixty-seven ten-thousandths ($\frac{67}{10,000}$), exactly what the plaintiff had before the dividend was declared.

In accordance with the provisions of the Federal income tax law, under section 2 of the act of October 3, 1915, entitled,

"An act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the plaintiff, in 1917, duly filed his return of income received during the year 1916. Under compulsion by said defendant, as collector of internal revenue for said
7 Eighteenth District of Ohio, plaintiff was compelled to, and did, file an amended return under protest, and paid the tax, and additional tax, assessed by said defendant, as collector of internal revenue for said district thereon. In determining the amount of taxable income received by the plaintiff during the year 1916, and in ascertaining and fixing the income tax due thereon, the said three hundred and thirty-five (335) shares of the par value of thirty-three thousand five hundred dollars ($33,500.00) of the National Acme Mannufacturing Company, received by plaintiff as such stock dividend, were required by said defendant, as such collector, to be included at eighty-six dollars and fifteen cents ($86.15) a share, or twenty-eight thousand eight hundred and sixty dollars

and twenty-five cents ($28,860.25), and plaintiff was required to, and did return said stock received, growing out of the formation of the National Acme Company, as if it were a sale for thirty dollars ($30.00) per fifty dollar ($50.00) share, or sixty dollars ($60.00) on one hundred dollars ($100.00), when in truth and in fact, at the time said agreement was made, and when said certificates for the capital stock of the National Acme Company were delivered to plaintiff, the stock had not been put upon the market and represented only ownership of the same assets which had been transferred to it by said The National Acme Manufacturing Company, and which, deducting liabilities and patents and good will, represented no more than forty dollars ($40.00) on the one hundred dollars ($100.00), or twenty dollars ($20.00) per share, or, in other words, represented no more than the stock for which it was exchanged, so that there was no profit and no income derived from said transaction of exchanging stock for stock.

Under said ruling said plaintiff was compelled to, and did make the return as set forth in the paper hereto attached, marked "Exhibit B" and made a part hereof. In said exhibit in the first column is placed the return as plaintiff was compelled to make it; in the second column, the return as it should have been made.

On the 27th day of April, A. D. 1917, plaintiff paid to said defendant, as such collector, three thousand four hundred and eighty-four dollars and ninety-three cents ($3,484.93), in payment of income tax, and on the 7th day of June, 1917, the further sum of five thousand nine hundred and thirty-three dollars and nine cents ($5,933.09). Said amended return, and said payment of the 7th of June, 1917, was made under protest in writing, the defendant threatening to
8 enforce the payment of said taxes, together with the penalties and interest, as provided by the act, by distraint and sale of property, and solely to avoid the imposition of penalties, and under compulsion, duress, and coercion.

Thereafter, the plaintiff duly took an appeal to the Commissioner of Internal Revenue, and demanded a repayment of said taxes, in accordance with law and the regulations and the rules of the Treasury Department. Said appeal was duly perfected and filed on the 13th of February, 1919. On the _____ day of _____, 1919, said Commissioner of Internal Revenue overruled said appeal, rejected said claim for repayment, and refused to refund the same, or any part thereof.

Said shares of stock of the National Acme Manufacturing Company, so received by the plaintiff, as aforesaid, on the 10th day of April, A. D. 1916, and said shares of stock of the National Acme Company, did not constitute taxable income under said act of Congress, and no tax was due, or has since become due to the United States Government or to defendant as collector of United States internal revenue for the eighteenth district of the State of Ohio by reason thereof. Said sum of six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84) was illegally

and without warrant or authority of law demanded and collected by the defendant from the plaintiff. No part of said sum of six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84) has been repaid to plaintiff, and the whole amount thereof, with interest thereon from the 7th day of June, 1917, remains due and owing from said defendant to this plaintiff.

This is a suit of a civil nature at common law, and the matter in controversy exceeds, exclusive of interest and costs, the sum of three thousand dollars ($3,000.00), and this suit, and the cause of action herein set forth, arises under the Constitution and laws of the United States, and under the laws of the United States providing for internal revenue. The act of Congress under which said sum of six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84) was levied, and its payment compelled, to wit, section 2 of the act of October 3, 1915, entitled,

"An act to reduce tariff duties and to provide revenue for the Government, and for other purposes,"

is invalid and void, in so far as the same may be asserted to confer power to make such levy, or to compel such payment, because
9 in violation of the provisions of article 1, section 2, clause 3 of the Constitution of the United States, to the effect

"That direct taxes shall be apportioned among the several States,"

and of the provisions of article 1, section 9, clause 4 thereof, to the effect that

"No capitation, or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken,"

and that the said act, as applied to the plaintiff, as aforesaid, did not lay a tax on income within the meaning of the 16th Amendment to the Constitution to the effect that

"The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

and this plaintiff hereby draws in question the constitutionality of said act of Congress, and of all provisions thereof assumed or asserted to authorize the said levy and the enforcement thereof.

Plaintiff therefore prays judgment against the defendant for the sum of six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84), with interest thereon from the 7th day of June, 1917.

WHITE, JOHNSON, CANNON & SPIETH,
Attorneys for Plaintiff.

STATE OF OHIO,
County of Cuyahoga, ss.:

John G. White, being first duly sworn, says that he is the plaintiff in the above-entitled petition, and that the facts therein stated and allegations contained, are true, as he verily believes.

JOHN G. WHITE.

Sworn to before me and subscribed in my presence by the said John G. White, the 24th day of April, A. D. 1920.

[SEAL.] J. E. SPLITTORF,
Notary Public.

10 In United States District Court.

Precipe for summons.

To the Clerk:

Issue summons in the above-entitled cause for defendant, returnable according to law. Endorse: "Amended petition for money only." Amount claimed six thousand one hundred and seventy-six dollars and eighty-four cents ($6,176.84), with interest thereon from the 7th day of June, 1917.

Dated this 24th day of April, A. D. 1920.

WHITE, JOHNSON, CANNON & SPIETH,
Plaintiff's Attorneys.

In United States District Court.

Exhibit A to amended petition.

This agreement, made by and between W. D. B. Alexander, A. W. Henn, and E. C. Henn, of Cleveland, Ohio, parties of the first part, hereinafter designated as vendors, and Messrs. Eastman, Dillon & Company, of New York, parties of the second part, hereinafter designated as purchasers, is to witness:

That whereas, the vendors are the owners of more than fourteen thousand (14,000) shares of the common capital stock of the National Acme Manufacturing Company of Cleveland, Ohio, organized under the laws of the State of Ohio; and

Whereas, the purchasers desire to acquire the same and such other shares as may be deposited hereunder:

Now, therefore, it is agreed:

First. The vendors agree to and will sell at their said shares of common capital stock to, and the purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, subject to the terms of this agreement, at and for the price of three hundred dollars ($300.00) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth; provided, however, and this contract is made upon the express condition, that it shall not become operative unless, on or before December 1st, A. D. 1916, at least eighty per centum (80%) of the entire outstanding common capital stock of said company is deposited hereunder, for sale in accordance with the terms hereof, with said depositary.

11 Second. Vendors have exhibited to the purchasers the financial statement of said The National Acme Manufacturing Company as of date of September 30th, 1916, and have stated that the combined earnings of its so-called "Windsor plant," recently acquired and its other plants, during 1916, will approximate five millions of dollars ($5,000,000), during the year 1915 were approximately two millions, five hundred thousand dollars ($2,500,000), and during the three years prior thereto, approximately from five hundred thousand (500,000) to eight hundred thousand (800,000) dollars per annum.

The purchasers shall, on or before December 1st, 1916, complete such examination, if any, as they desire to make of the company's books and property, to verify such statements of earnings and financial condition and the title to the company's properties, and shall on or before December 4th, advise the vendors of the result of such examination; and if no examination is made, or unless such examination, if made, disclose that such statements are not substantially correct, or that the titles of its property are defective in some serious respect not readily to be corrected, the purchasers shall proceed to pay for the deposited stock as herein provided. Provided that if the examination made by the purchasers disclose that such statements are not substantially correct, or that the title to its property are defective in some serious respect not readily to be corrected, and the transaction fail for that reason, the depositary shall forthwith return to the purchasers any moneys theretofore deposited by them hereunder, and shall return to the depositors their stock deposited with it.

Third. The vendors will, upon the execution hereof, deliver to the Cleveland Trust Company, of Cleveland, Ohio, as depositary, certificates of all their shares of the said common capital stock, duly endorsed for transfer, and subject the same to the terms of this agreement, and will make an effort to procure the deposit by all the other stockholders of said corporation of certificates of their shares of its said common capital stock, duly endorsed in blank for transfer, with said depositary, subject to the terms of this agreement, and to constitute the vendors, or a majority of them, attorneys in fact and proxies of the depositing stockholders to vote said stock in such manner as may be necessary to carry out the purposes hereof. If and whenever, on or before December 1st, 1916, the depositary shall notify the purchasers that there has been deposited with it at least
12 eighty per cent. (80%) of all said outstanding common capital stock, the purchasers will, within five (5) days from the date of such notice, deposit with said The Cleveland Trust Company, as such depositary, at Cleveland, Ohio, or for its account at the Chase National Bank, in the city of New York, as it may direct, subject to the terms of this agreement, the sum of five hundred thousand dollars ($500,000) in cash, and the further sum of seven millions of dollars ($7,000,000) within ten (10) days from the date of such notice.

Fourth. The purchasers and vendors will cause to be incorporated under the laws of the State of Ohio, a manufacturing corporation,

with generally similar powers to those of said The National Acme Manufacturing Company, under the corporate name of "The National Acme Company," or such other name similar thereto as the parties hereto may desire. Said corporation so to be formed shall have an authorized capital stock of twenty-five millions of dollars ($25,000,000) of common stock, divided into five hundred thousand shares of the par value of fifty dollars ($50.00) each. Upon the organization of said proposed corporation the purchasers and vendors will cause such proceedings to be had by its stockholders and directors as will cause it to purchase all the property and assets of every kind whatsoever of said The National Acme Manufacturing Company, including the good will of its business and subject to all its outstanding contracts and liabilities now or hereafter accrued, which are to be assumed by said new corporation and paid as they mature, in consideration of the sum of twenty-five millions of dollars ($25,000,000), payable by its entire authorized issue of stock, and to issue such stock in payment therefor.

The purchasers and vendors will use their best endeavor to cause such proceedings to be had by the stockholders and directors of said The National Acme Manufacturing Company as will cause all said property and assets, including its good will, to be sold to the newly organized company, at the price and on the terms above set forth, and full title thereto to be vested in that company, and to receive in payment therefor said capital stock of the newly organized company. The purchasers and vendors will cause all the stock of said newly organized company (except nine (9) qualifying shares of directors) to be issued to the Cleveland Trust Company, depositary, or such person as it may nominate, to be held and distributed by it as hereinafter provided.

13 Fifth. Said The Cleveland Trust Company, depositary, shall forthwith distribute said twenty-five millions of dollars (less qualifying shares), par value, of the common capital stock of said new company, and the said sum of seven million, five hundred thousand dollars ($7,500,000), in the following manner, to wit:

(a) If all the common stock of said The National Acme Manufacturing Company has been deposited with it, it will assign and transfer, or cause to be assigned and transferred to the purchasers or their order, one-half, or two hundred and fifty thousand (250,000) shares (excluding four qualifying shares for directors), of said capital stock of said newly organized company, and will, out of said sum of seven million, five hundred thousand dollars ($7,500,000), pay to each depositing stockholder an amount equal to one hundred and fifty dollars ($150.00) upon each share deposited by him. The depositary will, however, retain, with power to vote the same, the remaining one-half, or two hundred and fifty thousand shares (excluding five qualifying shares of said stock), until May 31st, A. D. 1917 (unless and to the extent that the purchasers may consent to earlier deliveries), at the expiration of which time it will assign and transfer, or cause to be assigned and transferred, said shares to the depositing stockholders, or their assigns, pro rata.

(b) If less than the entire amount of the common capital stock of the National Acme Manufacturing Company is deposited hereunder, the depositary shall follow a similar procedure, except that it shall retain ten (10) shares, (five from each one-half above named), of the capital stock of the new company, with power in itself or its nominee to vote the same, and one hundred and fifty dollars ($150.00) in money, on account of each share of stock not so deposited, until adjustment for the purchase of such non-deposited stock, under the laws of Ohio, or otherwise, can be had. The purchasers shall make whatever adjustment may be necessary to acquire such non-deposited stock, and to that end may make use of the shares of stock and money retained by the depositary under the provisions hereof, at the rate of, but not exceeding, one hundred and fifty dollars ($150.00), in cash and two hundred and fifty dollars ($250.00), par value, of said new stock for each of such old stock; and when such non-deposited stocks shall have been acquired by the purchasers, the depositary shall turn over to the pur-
14 chasers any shares or money then remaining in its hands; provided, however, that the vendors, if they desire, shall have the right to participate in the purchase of such non-deposited stock to the extent and upon the terms which may be deemed equitable by Messrs. A. H. Wiggin, president of the Chase National Bank of New York, and F. H. Goff, president of the Cleveland Trust Company, of Cleveland, Ohio; and provided, further, that in lieu of their portion of the retained stock above provided for, the purchasers may substitute and deposit such other collateral as meets the approval of said Wiggin and Goff.

Sixth. The vendors, being the active executive officers of the National Acme Manufacturing Company in the management of its business, hereby agree to accept and retain, if elected thereto, for a period of five years from and after its organization, the same offices or positions therein that they now hold in the present company, or offices or positions involving like duties, it being the desire of both parties hereto that the present management of the business be not interfered with by its transfer to the new company.

Seventh. The purchasers and vendors will, in the organization of the new company, cause its regulations to provide for a board of directors nine (9) in number, of whom four (4) shall be nominated by them and five (5) by the vendors.

Eighth. The purchasers and vendors, further agree that they will cause the new corporation to make application for and use their best efforts to have its stock listed upon New York, Boston, and Cleveland stock exchanges, and the vendors will cooperate with them therein.

Ninth. It is represented by the vendors that the one million, five hundred thousand dollars ($1,500,000), par value, of the outstanding preferred stock of the National Acme Manufacturing Company, has already been called by said company for redemption on January 1st, 1917, at the price of one hundred and five dollars ($105.00) per share and accrued dividends thereon at the rate of six per cent (6%), and they agree that said preferred stock will be in fact retired on or before the consummation of this deal, or that the cash required for such redemption will have been deposited by said company in the Cleveland Trust Company, as provided in the certificates of said

preferred issue as a separate fund for the full redemption of said issue, it being distinctly understood that all, or a portion, of the sum required for such redemption will or may be borrowed by said The National Acme Manufacturing Company for that purpose, and that its liability therefor will be a part of the indebtedness assumed by the new company in the transaction hereinbefore set forth.

Tenth. It is further agreed that during the pendency of this contract, provided the transaction is closed on or before January 1st, 1917, no dividends will be paid on the common stock of the present company other than its regular one per cent (1%) dividend to be declared on December 13th next.

Eleventh. It is further agreed that all the expenses of the formation of the proposed new company, including placing it in such position as to in every way carry out the portions of this agreement devolving upon it, the transfer from the old company to it of its property, the vesting in the new company of full title thereto and the dissolution of the old company, which shall be effected as soon as it legally may, shall be borne by the new company. All expenses, legal or otherwise, incurred by either of the parties hereto, on their own account and for their own benefit, shall be borne respectively by them.

Twelfth. It is further agreed that the Cleveland Trust Company, named as depositary herein, may issue receipts for stocks deposited with it, in accordance with and subject to the terms of this contract.

Thirteenth. The purchasers agree that all things to be done and performed by them will be completed on or before December 31st, 1916, so that the transaction may be closed on or before that date.

Fourteenth. If, in carrying out the terms of this contract, it is deemed desirable to make any modifications therein or additions thereto, the matter shall be submitted to said Messrs. A. H. Wiggin and F. H. Goff, who may make any such modification or addition which they deem advisable or desirable, other than change in price of the stock sold or time of payment therefor, which they have no power to modify.

In testimony whereof, said parties have hereunto affixed their signatures, this 8th day of November, A. D. 1916.

Vendors.

Purchasers.

16 *"Exhibit B" to amended petition.*

INCOME TAX.

For year 1816 as amended, and as it should have been—

	As filed.	Correct.
1. Gross income (brought from line 31)	$183, 161. 79	$91, 191. 29
2. General deductions (brought from line 40)	1, 376. 12	1, 386. 12
3. Net income	$181, 785. 67	$89, 805. 17
4. Dividends brought from line 30	$33, 166. 75	$4, 306. 50
5. Personal exemption (single $3,000; married or head of family, $4,000	3, 000. 00	3, 000. 00
6. Total dividends and personal exemption (items 4 and 5)	36, 166. 75	7, 306. 50
7. Amount of income subject to normal tax	$145, 618. 92	$82, 498. 67
8. Amount of normal tax at rate of 2 per cent on income shown on line 7	2, 912. 38	1, 649. 97
9. Credit by amount of normal tax paid or to be paid at source (1 per cent of amount of income shown on line 25, column A)	1. 50	1. 50
10. Balance of normal tax due	$2, 910. 88	$1, 648. 47

	Income.	Tax.	Income.	Tax.
1% on amount over $20,000 and not exceeding $40,000	20, 000. 00	200. 00	20, 000. 00	200. 00
2% on amount over $40,000 and not exceeding $60,000	20, 000. 00	400. 00	20, 000. 00	400. 00
3% on amount over $60,000 and not exceeding $80,000	20, 000. 00	600. 00	20, 000. 00	600. 00
4% on amount over $80,000 and not exceeding $100,000	20, 000. 00	800. 00	9, 805. 17	392. 21
5% on amount over $100,000 and not exceeding $150,000	50, 000. 00	2, 500. 00		
6% on amount over $150,000	31, 785. 67	1, 907. 14		
11. Total additional tax		6, 407. 14		1, 592. 21
12. Balance of normal tax due		2, 910. 88		1, 648. 97
13. Total tax due		9, 318. 02		3, 241. 18
Tax paid April 27, 1917			$3, 484. 93	
Tax paid June 7, 1917			5, 933. 09	
Total tax paid			$9, 418. 02	
Should have been			$3, 241. 18	
Overpaid			$6, 176. 84	

GROSS INCOME.

	A.	B.	A.	B.
16. Business, trade, commerce, or sales, or dealings in property, whether real or personal		129, 960. 25		67, 000. 00
18. Interest on notes, mortgages, bank deposits, and from all other sources other than reported on lines 19 and 22		1, 861. 68		1, 861. 68
19. Interest on bonds, mortgages, or deeds of trust, or other similar obligations of domestic corporations, joint-stock companies or associations, and insurance companies	150. 00		150. 00	
21. Partnership gains and profits, whether distributed or not		18, 023. 11		18, 023. 11
25. Totals	150. 00	149, 845. 04	150. 00	86, 884. 79
26. Aggregate totals		149, 995. 04		86, 884. 79
27. Dividends on stock of corporations, etc., subject to like tax	33, 166. 75		4, 306. 50	
30. Total dividends		33, 166. 75		4, 306. 50
31. Total gross income		183, 161. 79		91, 191. 29

GENERAL DEDUCTIONS.

33. All interest paid within the year on personal indebtedness of taxpayer	$250. 00	$250. 00
34. All national, foreign, State, county, school, and municipal taxes or taxes imposed by other taxpaying subdivisions of any State, paid within the year, not including those assessed against local benefits	436. 12	436. 12
36. Losses sustained during the year in transactions entered into for profit but not connected with any business or trade (no amount excess of aggregate income from these sources is allowable)	700. 00	700. 00
40. Total general deductions	$1, 376. 12	$1, 386. 12
Should be	$1, 386. 12	

17

In United States District Court.

Amended Answer to Amended Petition.

Filed Nov. 2, 1921.

Now comes E. S. Wertz, United States Attorney for the Northern District of Ohio, and leave of court having been first obtained, files this amended answer in behalf of Harry H. Weiss, Collector of

Internal Revenue for the Eighteenth District of the State of Ohio, defendant, in the above entitled action.

Defendant admits that plaintiff is a citizen of the State of Ohio and a resident of the Eighteenth Internal Revenue District of said State and that at all times mentioned in the amended petition of the plaintiff, defendant was and now is collector of internal revenue for the Eighteenth District of the State of Ohio. Defendant admits that the National Acme Manufacturing Company was during the year 1916 a corporation organized and existing under and by virtue of the laws of the State of Ohio, having an outstanding capital stock of four million ($4,000,000.00) dollars, divided into one million five hundred thousand ($1,500,000.00) dollars of preferred stock and two million five hundred thousand ($2,500,000.00) dollars of common stock, each share being of the nominal or par value of $100.00. Defendant admits that on or about the 15th day of March, A. D. 1916, said National Acme Manufacturing Company declared a stock dividend of 100% and that on said date plaintiff herein was the owner of 335 shares of the common capital stock of the said National Acme Manufacturing Company and that as a result of the declaration of said stock dividend, plaintiff herein became the owner of an additional 335 shares making him the owner of a total number of 670 shares of the common capital stock of the said National Acme Manufacturing Company. Defendant further admits that on or about the 8th day of November, 1916, the officers and stockholders of the National Acme Manufacturing Company entered into the agreement with Eastman, Dillon & Company of New York, copy of which agreement is attached to the petition of the plaintiff herein, and says that by the terms of said agreement said stockholders agreed to sell and said Eastman, Dillon & Company agreed to buy the stock of the National Acme Manufacturing Company for three hundred dollars ($300) per share to be paid as follows: One hundred fifty dollars ($150) in cash and five (5) shares of the common capital stock of a new corporation organized under the laws of the State of Ohio and known as
18 the National Acme Company; that said agreement was carried out by said stockholders of the National Acme Manufacturing Company and said Eastman, Dillon & Company and that pursuant to the terms of said agreement the stockholders of the National Acme Manufacturing Company authorized the execution of a contract dated November 21, 1916, by the terms of which contract the National Acme Manufacturing Company agreed to sell all of its assets and property of every nature to the National Acme Company; that the stockholders of the National Acme Manufacturing Company authorized the sale of all of the assets and property of the company to the National Acme Company and that said authorization was made in the manner and form prescribed by the laws of the State of Ohio, and that as a result of the action of the stockholders of the National Acme Manufacturing Company in so

authorizing the sale of all of the assets of said company, a bill of sale was duly executed by the authorized agents of the National Acme Manufacturing Company on December 4, 1916, by the terms of which bill of sale said National Acme Manufacturing Company sold to the National Acme Company all its property, real and personal, together with all contracts, moneys, accounts, bill receivable, rights, privileges, patents and good will. Defendant says that by reason of the execution of said agreement between the stockholders of the National Acme Manufacturing Company and Eastman, Dillon & Company, and of the subsequent action of said National Acme Manufacturing Company and its stockholders in carrying into effect the terms of said agreement, the plaintiff received one hundred thousand five hundred dollars ($100,500.00) in cash and certificates for 3350 shares of the Common capital stock of The National Acme Company.

Defendant admits that plaintiff filed an income tax return in 1917 purporting to show the income received by plaintiff during said calendar year of 1916 and that this defendant by virtue of his lawful authority compelled the plaintiff herein to file an amended return of the income received by the plaintiff during the said calendar year of 1916 and that in said amended return plaintiff was required to include said 335 shares of the common capital stock of the National Acme Manufacturing Company received by the plaintiff as a stock dividend as aforesaid at $86.15 a share or a total of twenty-eight thousand eight hundred and sixty dollars and twenty-five cents ($28,860.25) and also to include in said amended return said
19 3350 shares of the common capital stock of the National Acme Company received by plaintiff in accordance with said agreement between the stockholders of the National Acme Manufacturing Company and Eastman, Dillon & Company at $30.00 per share.

Defendant admits that the portion of the tax imposed against the plaintiff on said 335 shares of the common capital stock of the National Acme Manufacturing Company received by plaintiff as a stock dividend as aforesaid and returned at $86.15 per share or a total of $28,860.25 was illegally imposed and unlawfully collected; and that as to the sum of $1,731.62, being that portion of the income tax paid by plaintiff upon said shares so received as stock dividend, plaintiff is entitled to apply for and receive a refund as provided in said act of October 3, 1915.

Further answering, defendant says that the transaction between the plaintiff herein as a stockholder of the National Acme Manufacturing Company under said agreement of November 8th, 1916, and Eastman, Dillon & Company was a sale by the plaintiff to said Eastman, Dillon & Company of the stock owned by the plaintiff in said National Acme Manufacturing Company and that said sum of $100,500.00 in cash and said 3350 shares of the common capital stock of the National Acme Company received by the plaintiff from said

Eastman, Dillon & Company in payment for said stock of the plaintiff in the National Acme Manufacturing Company was income under the act of October 3rd, 1915, to the extent that said sum of $100,500.00 in cash and said 3350 shares of the common capital stock of the National Acme Company exceeded the price paid by the plaintiff for his stock in the National Acme Manufacturing Company for so much of the stock as was purchased by plaintiff after March 1, 1913, or the fair market value of said stock of the National Acme Manufacturing Company on March 1st, 1913, for so much of said stock as was purchased prior to said date and was properly taxable as such. Defendant therefore denies that the portion of said income tax paid by plaintiff on said 3350 shares of the comon capital stock of the National Acme Company was illegally assessed and collected. Defendant denies that section 2 of the act of October 3, 1915, is invalid and void or is in contravention of article 1, section 2, clause 3 of the Constitution of the United States or of the provisions of article
20 1, section 9, clause 4, thereof, or of the Sixteenth Amendment thereto, or of any other clause or provision thereof or amendment thereto.

Wherefore, defendant having fully answered, prays that the petition of the plaintiff herein be dismissed and that he may go hence without day.

E. S. WERTZ,
United States Attorney.

[Jurat showing the foregoing was duly sworn to by E. S. Wertz, omitted in printing.]

21 In United States District Court.

Motion for judgment on the pleadings.

Filed Oct. 8, 1921; refiled Nov. 2, 1921.

And now comes the plaintiff, John G. White, by White, Johnson, Cannon & Spieth, his attorneys, and moves the court here for a judgment on the pleadings and for cause of said motion says that the answer filed herein by said defendant to the amended petition of this plaintiff admits the averments of said petition and presents only a question of law as to whether or not, on the averments of the petition, plaintiff is entitled to a judgment and for how much.

WHITE, JOHNSON, CANNON & SPIETH,
Plaintiff's Attorneys.

In United States District Court.

Heard on motion for judgment on pleadings and submitted.

Entered Nov. 10, 1921, by D. C. Westenhaver, Judge.

This day this cause came on to be heard on the motion for judgment on pleadings and was argued by counsel, submitted to the court and taken under advisement by the court.

22 In United States District Court.

Memo. on motion.

Filed Feb. 17, 1922.

WESTENHAVER, District Judge.

This case is before me on plaintiff's motion for judgment on the pleadings. Defendant's answer admits the material allegations of plaintiff's petition and denies none of them except certain conclusions of law. The facts as pleaded are precisely those under consideration in Stearn vs. Weiss, this day decided, except that they are pleaded and set forth in greater detail and that the taxable income is to be calculated on a different basis.

For the reasons set forth in memorandum this day filed in Stearn vs. Weiss, plaintiff's motion for judgment on the pleadings is granted. An exception may be noted. Counsel may calculate the amount of the judgment proper to be entered and submit form of entry.

D. C. WESTENHAVER,
Judge.

February 17, 1922.

23 In the District Court of the United States, Northern District of Ohio, Eastern Division.

Title omitted.

Opinion.

Filed Feb. 17, 1922.

WESTENHAVER, District Judge:

This is an action brought to recover income taxes paid under protest. The parties, by stipulation in writing, have waived their right to a jury trial and have submitted the case to the court in lieu of a jury, upon an agreed statement of facts. The original agreed statement of facts filed herein April 9, 1920, as supplemented and amended by further agreement filed herein November 4, 1921, is adopted as my findings of fact and ordered to be filed as a part of the record. I have given due consideration to the questions involved, but my obligations in other directions are such that I shall do no more by way of opinion than to state briefly my conclusions. Whether or not the plaintiff is entitled to recover depends upon the correct understanding and meaning of the agreement in writing dated November 8, 1916, executed by W. D. B. Alexander, A. W. Henn and E. C. Henn, parties of the first part, and Eastman, Dillon & Company, of New York, parties of the second part. It is the Government's contention that this transaction as therein agreed and as

carried out was in substance and legal effect a sale by the first parties and all of the stockholders of the National Acme Manufacturing Company of their stock in said company, to the parties of the second part, at an agreed valuation of $300 a share, of which $150 was to be paid in cash and the residue in securities of a new and independent corporation to be organized and called The National Acme Company.

This being so, the Government further contends that the profit
24 made by each stockholder on the sale of its stock is income and that the amount of this profit is to be ascertained by adopting $300 a share as the sale price and deducting therefrom the cost to the stockholder of his stock, if bought since March 1, 1913, or the market value on March 1, 1913, if bought before that date. The plaintiff was a stockholder who participated on the basis set forth in said agreement.

All counsel agree that the substance and not the form of the transaction is controlling, and that the court will and must look through the machinery and verbiage in order to ascertain the true substance and nature of the transaction. Having done this, I am of opinion that the contention of the Government is not sound. The real transaction was a sale by the stockholders of the old company to Messrs. Eastman, Dillon & Company of a one-half interest in their shares of stock and a reorganization by the old stockholders and Eastman, Dillon & Company of the corporation, the substance and legal effect of which was to leave all stockholding interests and all the corporate assets in precisely the same situation after the transaction was fully carried out as it was when it was begun. Exhibit A is an agreement not between the old corporation and the new corporation, but between the stockholders of the old corporation and persons desirous of purchasing a one-half interest therein. The parties contemplated an increase of the capital stock from a par value of five million to a par value of twenty-five million and a reduction in the par value of each share from one hundred dollars a share to fifty dollars a share. In actual fact, this is all that was done or accomplished except the purchase by Eastman, Dillon & Company of one-half of the shares of the old company for $7,500,000. In order to accomplish this result and avoid legal difficulties, the transaction, it was contemplated when the agreement was made, was to take the form of a transfer from the old company to the new company of all the corporate assets. The new company was to have the same management and to be chartered for the same objects and purposes and under the laws of the same State. The result in substance and legal effect is the same as if the shares had merely been transferred on the books of the old company to Eastman, Dillon & Company and thereafter an amendment was made and filed to the charter of the old company reducing the par value of each of its shares from one hundred dollars to fifty dollars and increasing the par value thereof from five million to twenty-five million dollars. The
25 only reason why this course was not adopted is that probably greater difficulties would have been encountered in showing

that the new stock to be issued on the basis of five for one had in fact been fully paid up.

All this appears from the terms of the agreement and the agreed statement of facts. The stockholders of the old company, it must be held, sold one-half of their shares of stock to Eastman, Dillon & Company. They received therefor the sum of $150 in cash. They had no option of taking $300 in cash or of getting anything else except an increased number of shares of reduced par value as a result of the changes in corporate form and organization. Neither the new nor the old corporation parted with any of its property as a result of these transactions. The stockholders of the old company received no part of the assets of the old corporation. Nor did said corporation receive anything from the new to distribute from the old as a part of its surplus or capital for distribution among stockholders.

This being the true substance and legal effect of the agreement and of the transactions under consideration, it follows that the income derived or gained by plaintiff, and other stockholders similarly situated, from his stock in the old company or as a result of the sale made thereof, is the cash received by him less the cost of each share to him. Upon this basis it is agreed that the income tax assessed and collected, exceeds what should have been assessed and collected, by the sum of $268.89. Judgment will be entered accordingly. An exception may be noted.

Upon the law as applied to these facts, the case falls within the principles and holdings of the following authorities: Towne vs. Eisner, 245 U. S., 418; Southern Pacific Co. vs. Lowe, 247 U. S., 330; Gulf Oil Corp'n vs. Lewellyn, 248 U. S., 71, 72; Eisner vs. Macomber, 252 U. S., 189; Alpha Portland Cement Co. vs. United States (3 C. C. A.), 261 Fed., 339. See also Montgomery on Income Tax Procedure, Ed. 1918, pp. 95–98.

The case does not, in my opinion, fall within the principle and holdings of the authorities relied on by the Government; namely, Peabody vs. Eisner, 247 U. S., 347; Lynch vs. Hornby, 247 U. S., 339; Rockefeller vs. U. S., decided by U. S. Supreme Court November 21, 1921; United States vs. Phellis, decided by U. S. Supreme Court November 21, 1921.

The principles distinguishing these two classes of cases are definite and well understood. The difficulty, as usual, arises
26 in applying them to the facts of a given case and determining in the light thereof by which set of principles the given case is controlled. The distinguishing characteristic, however, is that the existing corporation must have segregated and placed within the exclusive control of the stockholders some part of its corporate assets, particularly of its profits or accumulated surplus, for, if the dividend is properly to be regarded as a liquidation of capital, then it is not to be regarded as income. In the present case nothing of this kind was done. Plaintiff and stockholders similarly situated, as already said, received purchase money for a sale of their stock from Eastman,

Dillon & Company, but nothing from the corporate assets of either company. Of the cases relied on by the Government, the case closest to the border line upon the facts is the Phellis case, but Mr. Justice Pitney emphasizes the characteristic thus noted as the basis of the court's decision. For instance, the old company, a New Jersey corporation, he says, "had accumulated an excess of assets over liabilities showing a surplus of accumulated profits; the precise amount is not important except that it should be stated that it was sufficient to cover the dividend distribution presently to be mentioned." Of the reorganization or merger of the corporations, he says, "It was a part of the purpose and a necessary result of the plan of reorganization, as carried out, that common stock of the new company to the extent of $58,854,200 should be turned over to the old company, treated by it as assets to be distributed as against its liability to stockholders for accrued surplus, and thereupon distributed to them 'as a dividend.' The assent of the stockholders was based upon this as a part of the plan." And, concluding, he says: "It thus appears that in substance and fact, as well as in appearance, the dividend received by claimant was a gain, a profit, derived from his capital interest in the old company, not in liquidation of the capital but in distribution of accumulated profits of the company; something of exchangeable value produced by and proceeding from his investment therein, severed from it and drawn by him for his separate use. Hence it constituted individual income within the meaning of the income tax law, as clearly as was the case in Peabody vs. Eisner, 247 U. S., 347." An examination of this case thus cited in support, will make plain the ground upon which this case is to be distinguished from the Phellis case.

D. C. WESTENHAVER,
Judge.

February 17, 1922.

27 In United States District Court.

Order of judgment for plaintiff for $8,126.45.

Entered March 31, 1922, by D. C. Westenhaver, Judge.

This cause came on to be heard on the amended petition of plaintiff, the answer of defendant thereto and motion of plaintiff for judgment on the pleadings. The court, being fully advised in the premises, grants said motion and proceeding to ascertain the amount by which the sum paid for income taxes exceeded the amount which should have been exacted, finds, by the agreement of counsel, that the amount of legal income tax which should have been assessed is two thousand nine hundred seventy-one and 90/100 dollars (2,971.90); that the amount which was actually exacted was $9,318.02, of which $3,484.93 was paid on the 27th of April, 1917, and $5,833.09 on the 7th of June, 1917.

It is therefore considered by the court that plaintiff recover of defendant the sum of $8,126.45.

It is further ordered that a certificate issue to said defendant, Harry H. Weiss, of probable cause to collect the amount exacted. Exception is allowed defendant to the findings and judgment of the court.

28 In United States District Court.

Petition for writ of error.

Filed May 13, 1922.

Now comes Harry H. Weiss, defendant herein, and says that on or about the 31st day of March, A. D. 1922, this court entered judgment herein in favor of the plaintiff and against this defendant, in which judgment and the proceedings had prior thereto in this cause certain errors were committed to the prejudice of this defendant, all of which will appear more in detail from the assignment of errors which is filed with this petition.

Wherefore this defendant prays that a writ of error may issue in this behalf out of the United States Circuit Court of Appeals for the Sixth Judicial Circuit for the correction of errors so complained of and that a transcript of the record, proceedings, and papers in this cause, duly authenticated, may be sent to the said Circuit Court of Appeals.

EDWIN S. WERTZ,
U. S. Attorney.
BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

29 In United States District Court.

Assignment of errors.

Filed May 13, 1922.

Harry H. Weiss, defendant in this action in connection with and as a part of his petition for a writ of error filed herein, makes the following assignment of errors which he avers were committed by the court in the rendition of the judgment against this defendant appearing upon the record herein, that is to say:

First.

The court erred in granting the motion of the plaintiff for judgment on the pleadings in this cause.

Second.

The court erred in rendering judgment against this defendant upon the granting of plaintiff's motion for judgment on the pleadings.

Third.

The court rendered judgment against this defendant, whereas judgment ought to have been rendered in favor of this defendant and against plaintiff.

Fourth.

The court erred in holding and deciding that the answer of this defendant did not state facts sufficient to constitute a defense to the matters set forth in the petition of the plaintiff herein.

Fifth.

The court erred in allowing interest upon the amount of income tax found to have been overpaid by the plaintiff herein.

Sixth.

The court erred in finding as a basis for granting plaintiff's motion for judgment on the pleadings that the plaintiff sold one-half of his shares of stock in The National Acme Manufacturing Company to Eastman, Dillon & Company and that the only income derived by the plaintiff from his stock in said The National Acme Manufacturing Company, as a result of the sale made thereof, was the cash received by him, less the cost of said shares so sold to plaintiff.

Wherefore this defendant prays that the said judgment may be reversed.

EDWIN S. WERTZ,
U. S. Attorney.
BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

30 In United States District Court.

Order allowing writ of error.

Entered May 13, 1922, by D. C. Westenhaver, Judge.

On this 13th day of May, A. D. 1922, the above named defendant, appearing by Edwin S. Wertz, United States attorney for the Northern District of Ohio, and filing herein and presenting to the court his petition praying for the allowance of a writ of error and assignments of error intended to be urged by him, and praying also that a transcript of the record and proceedings and papers upon which the judgment herein was rendered, duly authenticated, be sent to the United States Circuit Court of Appeals for the Sixth Judicial Circuit, and that such other and further proceedings may be had as may be proper in the premises:

Now, on consideration thereof, the court does allow the writ of error as prayed in the petition of the defendant, without bond of the

defendant, it appearing that the above entitled cause is one in which the United States, and not the record defendant, is the real party in interest, and this appeal is being taken by direction of the Department of Justice of the United States of America.

31 *Writ of error.*

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,
Sixth Judicial Circuit, ss.:

The President of the United States to the Honorable the Judge of the District Court of the United States for the Northern District of Ohio, greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, or some of you, between John G. White, plaintiff, and Harry H. Weiss, Collector of Internal Revenue for the Eighteenth District of the State of Ohio, defendant, a manifest error hath happened, to the great damage of the said Harry H. Weiss, Collector of Internal Revenue for the Eighteenth District of the State of Ohio, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if the judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ, so that you have the same at Cincinnati, in said circuit, on the* 11th day of June next, in the said Circuit Court of Appeals to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States should be done.

Witness the Honorable William Howard Taft, Chief Justice of the United States, the 12th day of May, in the year of our Lord one thousand nine hundred and twenty-two, and of the Independence of the United States of America the one hundred and forty-sixth.

B. C. MILLER,
Clerk of the District Court of the United States for the Northern District of Ohio.
[SEAL.] By M. E. BAUMAN,
Deputy Clerk.

Allowed by
D. C. WESTENHAVER,
Judge of the District Court.

32 [Blank return on writ of error form omitted in printing.]

*Not exceeding 30 days from the day of signing the citation.

33 [Citation in usual form showing service on John G. White omitted in printing.]

34 In United States District Court.

Certificate of probable cause.

Filed May 22, 1922.

Under the provisions of section 989, Revised Statutes of the United States, it is hereby certified that probable cause existed for the collection by Harry H. Weiss, as Collector of Internal Revenue for the Eighteenth Collection District of the United States, located in Cleveland, Ohio, of the income tax in question in the above-entitled cause from the plaintiff herein, and that in so collecting said income tax, said Harry H. Weiss acted under and by direction of the Commissioner of Internal Revenue of the United States.

D. C. WESTENHAVER,
Judge.

35 In United States District Court.

Order extending time.

Filed June 10, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to July 11, 1922.

Enter: _____,
U. S. District Judge.

Order extending time.

Filed July 10, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to August 10, 1922.

Enter: _____,
U. S. District Judge.

36 *Order extending time.*

Filed August 3, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to September 10, 1922.

Enter: _____,
U. S. District Judge.

Order extending time.

Filed September 9, 1922.

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to September 30, 1922.

Enter: _____,
U. S. District Judge.

37 In United States District Court.

Precipe for transcript.

To the clerk:

Please prepare transcript of record for the Circuit Court of Appeals in the above entitled cause, and include therein the following papers and orders:

Amended petition for money only and precipe filed.
Amended answer to amended petition filed by U. S. Attorney.
Motion of plaintiff for judgment on pleadings refiled.
Heard on motion for judgment on pleadings, taken under advisement ent.
Memorandum opinion of court filed.
Order of judgment on pleadings for plaintiff $8,126.45 exceptions allowed.
Petition for writ of error filed.
Assignment of error filed.
Order allowing writ of error filed and ent.
Writ of error.
Citation.
Certificate of probable cause filed.
And deliver all papers to the Toledo Legal Printing Company for printing.

EDWIN S. WERTZ,
U. S. Attorney,
and BERKELEY W. HENDERSON,
Asst. U. S. Attorney,
Attorneys for Defendant.

38 In United States District Court.

Certificate of clerk.

NORTHERN DISTRICT OF OHIO, ss.:

I, B. C. Miller, clerk of the District Court of the United States for said district, do hereby certify that the annexed and foregoing pages contain a full, true and complete copy of the final record, including the petition for writ of error, assignment of errors, and all proceedings in said cause, in accordance with the praecipe for transcript filed by plaintiff in error, the originals of which are now in my custody as clerk of said court.

There is also annexed to and transmitted with such transcript of record the writ of error and the citation issued and allowed in this case.

In testimony whereof, I have hereunto signed my name and affixed the seal of said court, at Cleveland, in said District, this ------ day of June, A. D. 1922, and in the 146th year of the Independence of the United States of America.

B. C. MILLER,
Clerk,

[SEAL.] By M. E. BAUMAN,
Deputy Clerk.

39 PROCEEDINGS IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Cause argued in part December 6, 1922.

Before DENISON and DONAHUE, Circuit Judges, and PECK, District Judge.

These causes are argued together by Mr. Berkeley W. Henderson, assistant United States attorney, and are continued until tomorrow for further argument.

Further argued and submitted, Dec. 7, 1923.

These causes are further argued by Mr. Berkeley W. Henderson, assistant United States attorney, and by Mr. C. M. Charest, special attorney, Bureau of Internal Revenue, on behalf of the plaintiff in error, and by Mr. John G. White on his own behalf and by Mr. Charles P. Hine on behalf of Louis Stearn, and are submitted to the court.

40 United States Circuit Court of Appeals for the Sixth Circuit.

Judgment.

Filed Jan. 9, 1923.

Error to the District Court of the United States for the Northern District of Ohio. This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Ohio and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said District Court in this cause be and the same is hereby affirmed.

41 Nos. 3759 and 3790.

United States Circuit Court of Appeals, Sixth Circuit.

HARRY H. WEISS, COLLECTOR OF INTERNAL revenue for the eighteenth district of the State of Ohio, plaintiff in error,
vs.
LOUIS STEARN, DEFENDANT IN ERROR.

HARRY H. WEISS, COLLECTOR OF INTERNAL revenue for the eighteenth district of the State of Ohio, plaintiff in error,
vs.
JOHN G. WHITE, DEFENDANT IN ERROR.

Error to the United States District Court for the Northern District of Ohio, Eastern Division.

Opinion.

Filed Jan. 9, 1923.

Submitted December 7, 1922; decided January 9, 1923.

Before DONAHUE and DENISON, Circuit Judges, and PECK, District Judge.

PECK, District Judge: The question involved in these cases is whether the defendants in error were, by the District Court, properly regarded, for the purposes of income taxation under the revenue law of 1916 (39 Stats. 757) as having disposed with profit of only one-half of their respective stock holdings in the National Acme Manufacturing Company, or whether they should have been considered as having so disposed of the entirety.

The transaction in question was had pursuant to a contract between the stockholders and Eastman, Dillon & Company, by the first paragraph of which the former apparently agreed to sell, and the latter to buy, the stock "at and for the price of three hundred
42 dollars ($300) per share, payable, one-half in cash and one-half in securities, as hereinafter set forth." But the real transaction specifically required by the subsequent provisions of the contract and actually consummated was as follows:

The stockholders delivered all of their stock to an intermediary, the Cleveland Trust Company, in trust. For each share so deposited they were to, and later did, receive $150 cash and five shares of new stock of the nominal par value of $50 each, but actually valued at $30 per share for the purposes of the bargain, being, in the aggregate, one-half (250,000 shares) of the stock of a new corporation formed to take over the business. Eastman, Dillon & Company, in order to acquire the other half of the stock of the new corporation, paid to the trustee $7,500,000, being at the rate of $30 per share for 250,000 shares. The vendors and vendees then proceeded to organize the new corporation under the laws of the same State, Ohio, with the same powers and the same name, except for the dropping of the word "Manufacturing." Its capital stock, 25,000,000, was five times that

of the old concern, and was divided into shares of the denomination of fifty, instead of one hundred, dollars each, as theretofore. Accordingly there were ten $50 shares of the new for each $100 share of the old stock. The new corporation issued all of its stock to the trustee in exchange for all the assets subject to the liabilities of the old company. The trustee delivered one-half (250,000) of the shares of the new stock to Eastman, Dillon & Company, in consideration of the $7,500,000 paid in, and distributed pro rata among the old stockholders the other half, 250,000 shares, and the $7,500,000 at the agreed rate of $150 and five shares of the new for each share of the old stock. The old company was then dissolved and the new corporation continued business under the same management.

The net results, putting to one side for the moment the matter of re-incorporation, were that the capital stock of the concern was increased five-fold, the face value of the shares cut in half, and that the old stockholders sold Eastman, Dillon & Company one-half of their respective holdings at the price of $30 per share for the new stock. The income tax on such profit as was made on that half which was so sold was paid by defendants in error, who were among the old stockholders. They were, however, further compelled
43 to pay a like tax because of the receipt of the other half of the new stock in exchange for the old, the Government claiming that they made the same gain thereby as upon the half which they had sold; and for the recovery of this they sued and had judgment below.

It is clear that the half in question was not sold to Eastman, Dillon & Company. This is true despite the above-quoted language of the first paragraph of the agreement, as substance must dominate form; and what was done, rather than what was agreed to be done, is the final criterion. United States *v.* Phellis, 257 U. S. at page 172. As to this half, the legal title never went to Eastman, Dillon & Company, nor beyond the Cleveland Trust Company, which held it for the benefit of the old stockholders, in whom the equity continued, until the agreed equivalent in new stock was delivered to them and the old stock retired by the dissolution of the old corporation. Therefore, if the transaction as to this half resulted in taxable gain at all, it was not as the consequence of any sale to Eastman, Dillon & Company, but must be looked for in the transaction had between the old stockholders, the rustee, and the corporation.

The old corporation went through the form of an exchange of its assets for the new stock and a distribution thereof among its shareholders as upon final dissolution. There was nothing that can be properly called a sale of the half of the stock under consideration in any aspect of the case. The question to be decided resolves itself, therefore, to this: Is there taxable income to the stockholder in the receipt of shares of greater face value and actually worth more than the cost to him of old shares for which they are exchanged upon the occasion of a reorganization accomplished by the taking down of an old corporate structure and the setting up in its place of a new

one with the same powers under the laws of the same State, but having greater capital stock, with a taking over of assets subject to liabilities and a continuance of the business under the same management and name?

It is the present policy of Congress, as shown by the statute now in force, to regard such a transaction as non-taxable (Revenue Act of 1921, ch. 136, p. 230, sec. 202 [c] [2]), although under the act of 1918 the matter had been made dependent upon the comparative face values of the old and new securities (40 Stats. 1060, sec. 202 [b]). The law of 1916, however, under which this case arises, did not deal expressly with exchanges of stock upon corporate reorganizations, and the case is left to be determined upon the general definition of that which is taxable as "including gains, profits and income derived from * * * business, trade, commerce or sales or dealings in property, whether real or personal * * * also from interest, rent, dividends, securities, or the transaction of any businss carried on for gain or profit, or gains or profits and income derived from any source whatever." (Section 2 [a]).

Except for change of corporate entity there was here a continuance of the same concern. The assets were the same, and the stockholders (assuming the sale of the other half to have been consummated) were the same, and in the same proportions: the domicile, the powers, the name, substantially, and the corporate obligations were all left as before. The same ends might have been achieved by an amendment of the articles of incorporation providing for the increase of the capital stock, the reduction of the face value of its shares, and the change of name. Had this method of accomplishing the identical result been pursued, the increase in face value of the new certificates issued to the holders in exchange for the old would have been plainly a mere stock dividend, non-taxable under Eisner *v.* Macomber, 252 U. S. 189. Therefore, if the transaction be taxable it must be because of the giving up of the old and the taking on of the new charter. It is true that a new corporate being has intervened, but where a corporate entity has been found to be a mere matter of form, it has been disregarded in similar transactions in respect to income taxation. Southern Pacific Co. *v.* Lowe, 247 U. S. 330; Gulf Oil Co. *v.* Llewellyn, 248 U. S. 71; Alpha Portland Cement Co. *v.* United States, 261 Fed. 339; although it is not so when it is a matter of substance. Eisner *v.* Macomber and United States *v.* Phellis, supra. The latter case, strongly relied upon by plaintiff in error, does not present a parallel situation. There the surplus had been separated from the capital for the purpose of distributing it among the stockholders in the form of the stock of a new corporation to which the assets were conveyed. But the old corporation continued to exist, its stock remained outstanding, and the segragation of capital from surplus was accomplished by setting over to it assets equal to its capital stock and capable of returning future dividends to its stockholders. In that state of affairs the Supreme

Court said of the stockholder: "* * * he could sell his entire portion or any of it" (i. e. his dividend) "without parting
45 with his capital interest in the parent company, or affecting his proportionate relation to the interests of other stockholders. Whether he sold the new stock for money or retained it in preference, in either case when he received it he received as his separate property a part of the accumulated profits of the old company in which previously he had only a potential and contingent interest." Rockefeller *v.* United States, 257 U. S. 176, likewise involved a distribution of the stock of a corporation created to take over part of the surplus of the parent corporation while the existence of the latter continued. Peabody *v.* Eisner, 247 U. S. 347, exhibited the case of a distribution, as a dividend, of the stock of another corporation held by the parent company. In each of those cases there was a segregation of accumulated surplus and a distribution of it in the stock of a corporation other than the parent company, both corporations continuing to exist.

In the present case there has been no attempt on the part of the concern to segregate or distribute its surplus, but merely a reorganization accompanied by a stock dividend. It has not been divided into two corporations, one to hold the capital, the other to take the earnings, as in the cited cases. The old charter was surrendered when the new one was taken. The venture of the stockholder in the hazard of the business continues undivided. He has not drawn out his profit. His investment is still entirely in the same enterprise, albeit represented by new certificates, yet essentially the same. For these reasons it is concluded that the distribution upon reorganization of the new stock in exchange for the old did not involve taxable income. Accordingly the judgment of the District Court is affirmed.

46 United States Circuit Court of Appeals for the Sixth Circuit.

Clerk's certificate.

I, Arthur B. Mussman, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the foregoing is a true and correct copy of the record and proceedings in the case of Harry H. Weiss, collector, etc., vs. John G. White, No. 3790, as the same remains upon the files and records of said United States Circuit Court of Appeals for the Sixth Circuit, and of the whole thereof.

In testimony whereof, I have hereunto subscribed my name, and affixed the seal of said court, at the city of Cincinnati, Ohio, this 20th day of March, A. D. 1923.

[SEAL.] ARTHUR B. MUSSMAN,
Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

47 *Writ of certiorari and return.*

Filed July 5, 1923.

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America, to the Honorable the Judges of the United States Circuit Court of Appeals for the Sixth Circuit, greeting:

Being informed that there is now pending before you a suit in which Harry H. Weiss, collector of internal recenue for the eighteenth district of the State of Ohio, is plaintiff in error, and John G. White is defendant in error, No. 3790, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the Northern District of Ohio, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Supreme
48 Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable William H. Taft, Chief Justice of the United States, the twenty-third day of June, in the year of our Lord one thousand nine hundred and twenty three.

[SEAL.] WM. R. STRANSBURY,
Clerk of the Supreme Court of the United States.

In the Supreme Court of the United States, October Term, 1922.

I, Arthur B. Mussman, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the transcript of the record of the proceedings of this court in the within entitled case heretofore certified by me for filing in the Supreme Court of the United States was correct and complete as the same then appeared in this court.

In pursuance of the command of the foregoing writ of certiorari I now hereby certify that on the 3rd day of July A. D., 1923, there was filed in my office a stipulation in the above entitled case in the following words, to wit:

In the Supreme Court of the United States, October Term, 1922.

[Title omitted.]

Stipulation as to return to writ of certiorari.

It is hereby stipulated by counsel for the parties to the above entitled cause that the certified copy of the transcript of the record

now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Sixth Circuit to the writ of certiorari granted therein.

WM. J. HUGHES,
For the Solicitor General.
WHITE, CANNON & SPIETH,
Counsel for Respondent.

June 29, 1923.

I further certify that the above is a true and correct copy of said stipulation and of the whole thereof. Witness my official signature and the seal of said Circuit Court of Appeals at the city of Cincinnati in said circuit this 3rd day of July A. D. 1923.

[SEAL.]

ARTHUR B. MUSSMAN,
Clerk United States Circuit Court of Appeals for the Sixth Circuit.

49 [File endorsement omitted.]

50 [File endorsement omitted.]

○

No. 886

In the Supreme Court of the United States

October Term, 1922.

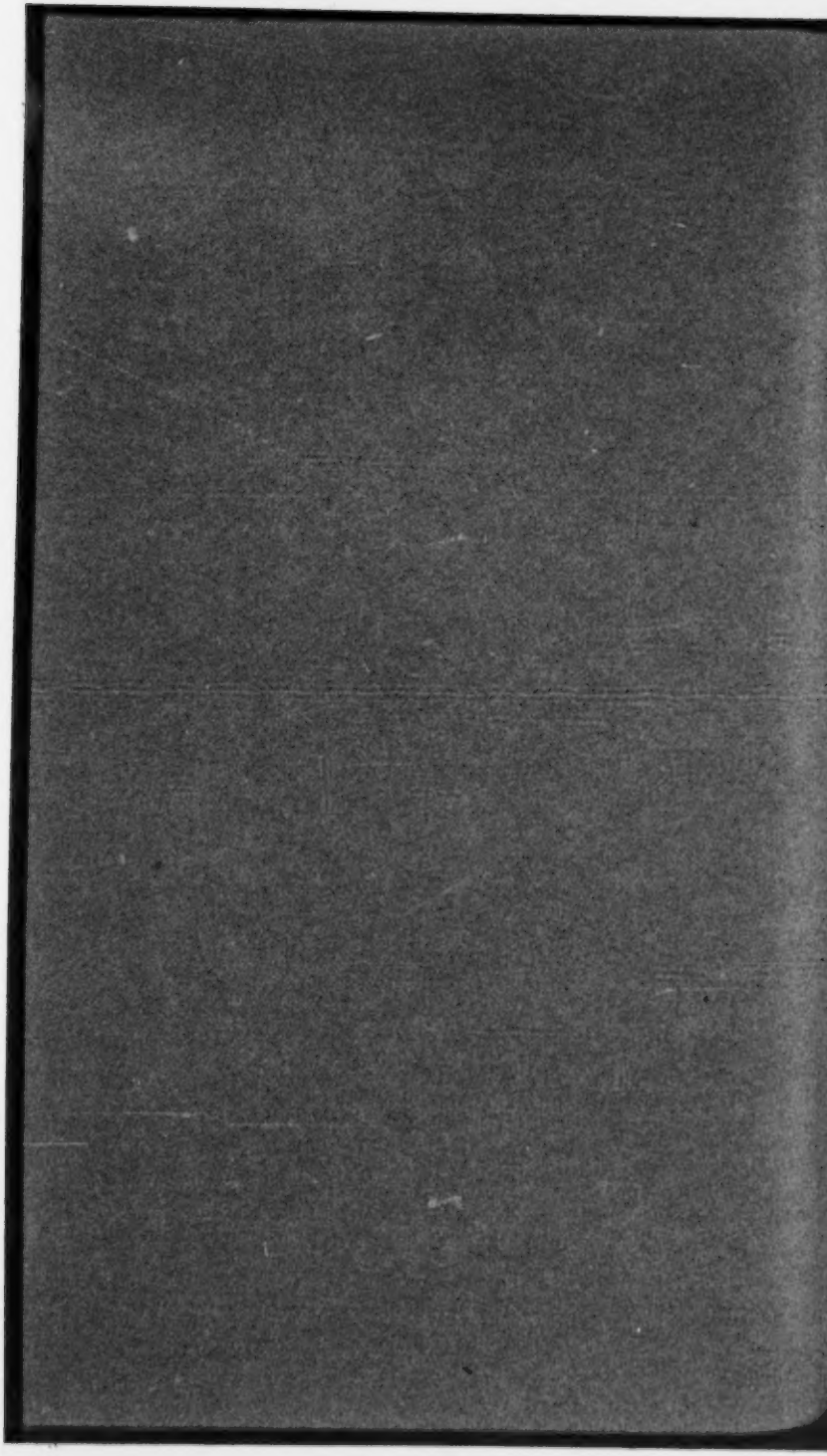
HARRY H. WEISS,
Collector of Internal Revenue,
Petitioner,

vs.

JOHN G. WHITE,
Respondent.

BRIEF FOR RESPONDENT ON PETITION FOR WRIT OF CERTIORARI.

JOHN G. WHITE,
A. V. CANNON,
W. H. ANNAT,
Attorneys for Respondent.



No. .....

In the Supreme Court of the United States

October Term, 1922.

HARRY H. WEISS,
Collector of Internal Revenue,
Petitioner,

vs.

JOHN G. WHITE,
Respondent.

BRIEF FOR RESPONDENT ON PETITION FOR WRIT OF CERTIORARI.

JOHN G. WHITE,
A. V. CANNON,
W. H. ANNAT,
Attorneys for Respondent.

No. .....

In the Supreme Court of the United States

October Term, 1922.

HARRY H. WEISS,
Collector of Internal Revenue,
Petitioner,

vs.

JOHN G. WHITE,
Respondent.

BRIEF FOR RESPONDENT ON PETITION FOR WRIT OF CERTIORARI.

We file this brief chiefly for the purpose of correcting several important inaccuracies in the petition for certiorari, and in the brief in support of the petition.

The facts are these:

In April, 1916, The National Acme Manufacturing Company paid a stock dividend of one hundred per cent. The respondent was compelled to, and did, pay income tax on this dividend. It has been conceded all through the case that the respondent is entitled to recover this back in this proceeding.

The question really in dispute arises out of a transaction had in November and December, 1916, and this question depends entirely upon the construction of a specific written contract made at that time between the representatives of the owners of the capital stock of The National Acme Manufacturing Company and Eastman, Dillon & Company, of New York. The National

Acme Manufacturing Company was an Ohio corporation. It had an authorized capital stock, so far as concerns this case, of five millions of dollars. Its tangible assets, excluding good will and patents, were of the value of at least ten millions of dollars. It had been very prosperous for a number of years, so that its good will, that is to say its expectation of making future profits, was very valuable. The past profits had been invested in the business, which explains the surplus of value of its assets over the amount of its stock.

Under these circumstances, the contract in question was made. It was construed in the same way by both the District Court and the Circuit Court of Appeals. By that contract, as thus construed, and as we claim correctly construed, the stockholders transferred one-half of the stock to Eastman, Dillon & Company for $7,500,000.00 in cash. This gave each of the old stockholders $150.00 a share. They conceded that this was income, and the income tax was paid thereon, and no question arises out of it. The remaining one-half of the stock never passed for a minute to Eastman, Dillon & Company. As a result of the transaction thus far, Eastman, Dillon & Company owned one-half of the stock of The National Acme Manufacturing Company, and the old stockholders retained half of the stock, each stockholder owning exactly half of the stock which he had before. It was further agreed that the old stockholders and Eastman, Dillon & Company, together constituting the whole body of the stockholders of the old company, should organize a new company under the laws of Ohio, under the name of The National Acme Company, so as to retain the good will; that the capital stock of the new company should be Twenty-five Million Dollars ($25,000,000.00), divided into shares of

Fifty Dollars ($50.00) each; that the new company should take over all the assets and liabilities of the old company, and should issue to the stockholders of the old company, made up, as just stated, of the original stockholders and of Eastman, Dillon & Company, all of the stock of the new company in exchange for these assets, and subject to these liabilities; that the old company should be at once dissolved. There were other provisions upon which it is unnecessary to enlarge, providing for the election of a Board of Directors controlled by the old stockholders, retaining the old officers and managers, and obligating the old stockholders not to market their stock for a number of months.

This agreement was actually carried out. The new company was organized according to the agreement; the old company was dissolved, so that never did The National Acme Manufacturing Company and The National Acme Company exist, side by side; never were there at the same time stockholders of the old company and stockholders of the new company; there was never any segregation of assets or of stock; no new capital went into the new corporation; stock was not issued as against any segregated part of the assets nor against profits or surplus. The respondent, after the reorganization and the receipt of his stock in the new company, had precisely the same interest in the same assets, subject to the same liabilities, as he had in the old company, after he had sold half his stock to Eastman, Dillon & Company. The purposes of the two corporations were exactly the same; they existed under exactly the same law and authority. This being true, it is plain that the statements made in the application for the writ of certiorari are incorrect. The stockholders did not sell their stock in The National Acme Manufacturing

Company to Eastman, Dillon & Company; they did not receive from Eastman, Dillon & Company any stock in the newly organized National Acme Company. This incorrect statement is reiterated in the brief, where it is said:

> "The stockholders sold their shares in The National Acme Manufacturing Company for $150.00 cash and five (5) shares of stock in the new company for each share of stock in the old,"

Neither is it true that the undivided interest of the individual stockholder in any surplus has been released to and drawn by him as profit or income from his original capital investment. This is not true, unless *Eisner vs. Macomber,* was incorrectly decided.

Again, it is said in the brief:

> "it is certainly not true that stockholding interests were identical."

It *is* certainly true that stockholding interests were identical. Before the transfer of the assets to the new corporation, the old stockholders owned one-half of the stock of The National Acme Manufacturing Company, and Eastman, Dillon & Company owned the other half. After the transfer, the old stockholders owned one-half of the stock of the new company, and Eastman, Dillon & Company the other half.

It is stated in the petition for certiorari that the decision of the Circuit Court of Appeals is directly opposite to the ruling of the Treasury Department. The actual rulings of the Treasury Department were these: In a letter addressed by Commissioner W. H. Osborn to A. G. Dickson, dated May 3, 1915; *Corporation Trust Company's Income Tax Service* 1916, paragraph 1779:

> "This office is in receipt of your letter of the 21st ultimo, amended by your letter of the 23rd, in

which is presented the following proposition for ruling of this office:

> 'A corporation having a capital stock of $500,000 has accumulated a surplus of $500,000 in addition to paying handsome dividends upon its capital stock. This company proposes to sell, or rather transfer to a reorganized company in which the stockholders and their proportionate interests are the same, all of its assets and good will for $5,000,000 par value of the second company's capital stock. The good will involved in the above proposition has been created entirely by the first company, and the earning capacity of the first company would appear to justify the suggested transaction.'

In reply to your inquiry as to whether or not the difference in the nominal par values of the stocks of the two companies will be treated as taxable income, you are informed that the value of the tangible assets in this case is that represented by the original capital and the surplus of the first company of $1,000,000. Whatever value the business and properties had over $1,000,000 was the value of the good will. Good will is an intangible asset subject to neither appreciation nor depreciation in so far as taxable income is concerned. The conversion of good will into any form of assets other than cash or its equivalent does not constitute income.

In the case cited the $5,000,000 capital stock issued in payment for the assets (tangible and intangible) of the first company is in fact of no greater value than is that of the $500,000 of the first company, for the reason that in each case the value of the stock is based upon and supported by the same assets, and until the stock issued by the purchasing or reorganized company in payment for the assets of the first company is converted into cash or its equivalent, no taxable income will have

> been realized from the transaction. In other words the excess of the nominal par value of the stock issued in payment for assets, over the nominal par value of the stock of the selling company, the stock in both cases being supported by the same assets, does not constitute income within the meaning of the Federal income tax law."

After this decision was made, on the 9th of September, 1916, the Treasury Department reversed this ruling by letter from Commissioner W. H. Osborn, the same Commissioner who made the other ruling, to A. C. Kahn, but prefaced its reversal by saying:

> "In reply your attention is called to Treasury Decision 2274 (Paragraph 1205), a copy of which is herewith enclosed. This decision, you will observe, modified the ruling made in the letter addressed to Mr. Dickson; in fact, according to the last paragraph of this decision, 'all rulings, or parts of rulings, heretofore made, which are in conflict herewith, are hereby revoked'."
>
> *Corporation Trust Company, Income Tax Service* 1917, par. 1217.

So it appears that this decision was based on Treasury Decision 2274. Turning now to Treasury Decision 2274, which is thus the basis of reversal, we find it to be as follows:

> "Stock dividends paid from the net earnings or the established surplus or undivided profits of corporations, joint stock companies or associations, and insurance companies are held to be the equivalent of cash and to constitute taxable income under the same conditions as cash dividends."
>
> *Corporation Trust Company, Income Tax Service,* 1917, par. 1205.

This ruling of the Treasury Department, of course, was overruled by the *Macomber* case, and hence the

whole basis for the ruling of September 9, 1916, disappears. But, it is important to thus learn that the basis of the Treasury Department ruling, which your Honors are now asked to sustain, was an opinion of the Department overruled by this Court in the *Macomber* case, and that, in the opinion of the Department, expressed in both rulings, the transaction is merely a stock dividend.

Neither is it accurate to say that in consequence of this ruling of the Treasury Department a large amount of taxes have already been collected. The decisions of the District and of the Circuit Court of Appeals decide not a general question, but a question arising simply on this particular contract, and is as to the construction of *this* contract.

It is, therefore, not accurate to say, as stated in the petition for certiorari,—

> "If the decision stands, numerous other suits may be expected, with strong possibility of conflicting decisions in other circuits."

The decision affects only stockholders in this one company. It is equally inaccurate to say:

> "The question is of grave importance to the administration of the Internal Revenue Laws, which this decision leaves in great confusion."

On the contrary, assuming, as we do, that the construction of the contract by the District Court and the Circuit Court of Appeals is correct, the result necessarily follows under *Eisner vs. Macomber,* and equally under the decision referred to by the Solicitor General, of *U. S. vs. Phellis,* 257 U. S. 156.

Towne vs. Eisner, 245 U. S. 418;

U. S. vs. Alpha Portland Cement Co., 242 Fed. 978;

S. C. 257 Fed. 432;
S. C. 261 Fed. 339.

This was not a case where a corporation, having as part of its assets shares in another company, distributes those shares among other stockholders. *Peabody vs. Eisner,* 247 U. S. 347. Nor yet one where a corporation sells parts of its capital assets and distributes the money among its stockholders by means of a dividend. *Lynch vs. Hornby,* 247 U. S. 339. But rather one like *Southern Pacific Co. vs. Lowe,* 247 U. S. 330; *Gulf Oil Corp. vs. Lewellyn,* 248 U. S. 71, 72. It is sustained by

Phellis vs. U. S., 257 U. S. 156;
Rockefeller vs. U. S.;
New York Trust Company vs. Edwards;

cited by the Solicitor General, all three of which cases distinguish such a case as the one now under consideration.

We repeat, no new assets went into the new corporation; the old corporation at once went out of existence, its stock no longer existed, but there was substituted the stock of the new company. The purposes of the two corporations were the same; they were incorporated under the laws of the same state. It was part of the agreement that the managers of the old company should continue managers of the new company. The name of the new company was such as to retain the good will of the old. After the transaction was complete, there was only one body of stockholders who were the same persons as before the reorganization, owning the same proportion thereof and their stock represented exactly the same property that had been represented by the old stock. The only difference

was that the new corporation was capitalized for a larger amount, (all of the stock of which was issued at once for the old assets) and that the size of the shares was different. There was substantial identity between the old and the new corporation, as determined by all the tests applied in all the cases to which reference has been made.

In the three cases last cited this Court said that where such circumstances existed as exist in this case there was no income created by the transaction.

Thus, the decision in the case under consideration established no new law, but applied the law uniformly declared by this Court to the special circumstances of a particular contract.

Respectfully submitted,

JOHN G. WHITE,
A. V. CANNON,
W. H. ANNAT,
Attorneys for Respondent.

No. 248.

In the Supreme Court of the United States

October Term,
1923.

HARRY H. WHITE, Collector of Internal Revenue,
Petitioner,

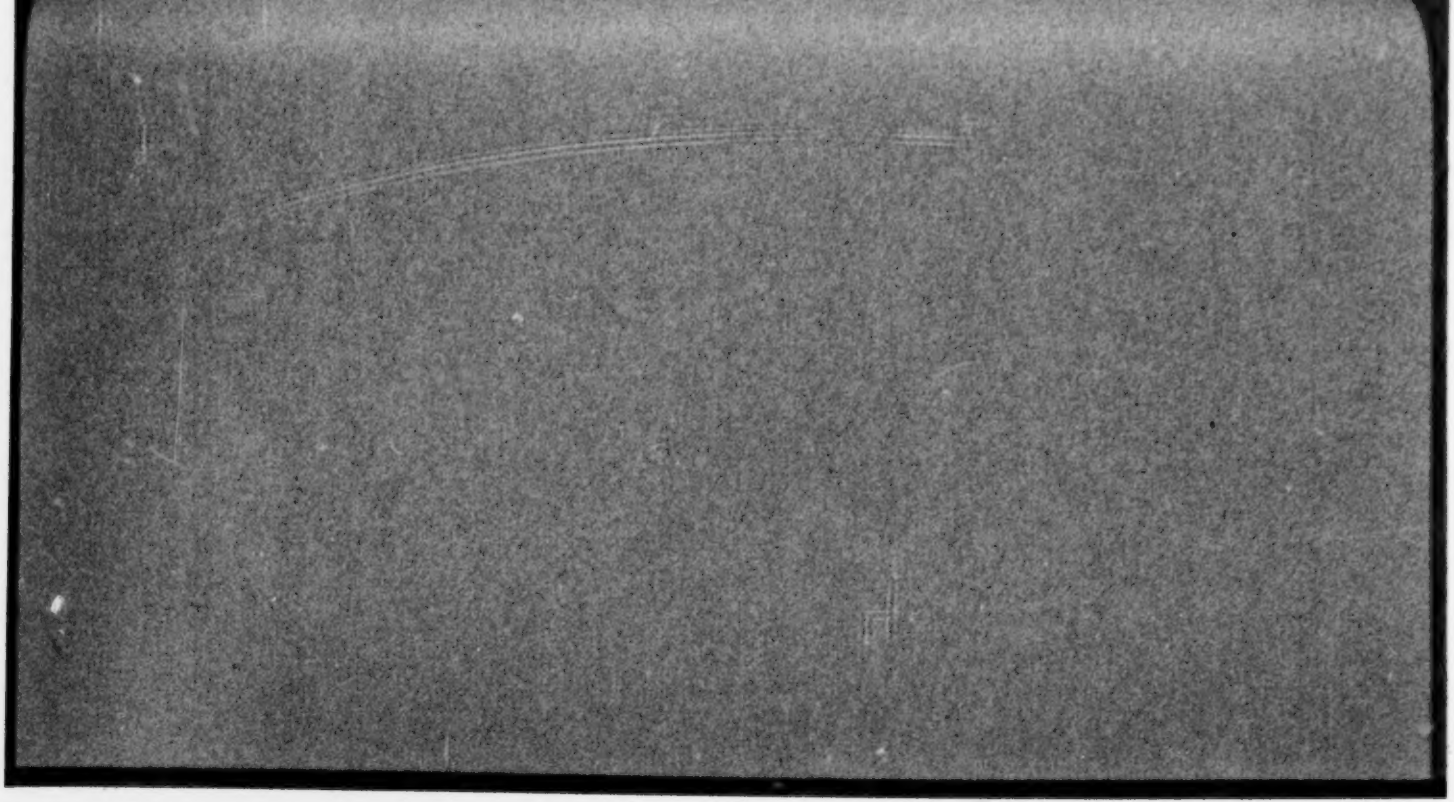
vs.

JOHN G. WHITE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

JOHN G. WHITE,
A. P. CANNON,
L. C. SPIETH,
Attorneys for Respondent.



No. 263.

In the Supreme Court of the United States

October Term,
1923.

HARRY H. WEISS, Collector of Internal Revenue,
Petitioner,

vs.

JOHN G. WHITE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

JOHN G. WHITE,
A. V. CANNON,
L. C. SPIETH,
Attorneys for Respondent.

CASES CITED.

Alpha Portland Cement Co. vs. United States, 261 Fed. 339, 340, *et seq.* 25, 33

Corporation Trust Company, Income Tax Service, 1917, Par. 1217 17

Corporation Trust Company, Income Tax Service, 1917, Par. 1205 18

Crocker vs. Malley, 249 U. S. 223, 233 36

Cullinan vs. Walker, 262 U. S. 134, 137-8 ..... 37, 45, 46

Eisner vs. Macomber, 252 U. S. 189, 206 *et seq.* 15, 18, 19, 25, 33, 41, 42, 55

Gould vs. Gould, 245 U. S. 151, 153 36

Gulf Oil Corporation vs. Llewellyn, 248 U. S. 71, 72 ..... 36, 48, 50, 53

Lynch vs. Hornby, 247 U. S. 339 34

Peabody vs. Eisner, 247 U. S. 347, 349-350 34

Rockefeller vs. U. S., 257 U. S. 176 ..... 37, 43, 44, 45

Southern Pacific Co. vs. Lowe, 247 U. S. 330, 337 ..... 35, 48, 49

Tax Commissioners vs. Putnam, 227 Massachusetts, 522 51

The New York Trust Company, et al., vs. Edwards, Collector 43

Towne vs. Eisner, 245 U. S. 418 18

United States vs. Alpha Portland Cement Co., 242 Fed. 978 25

United States vs. Alpha Portland Cement Co., 257 Fed. 432, 434, *et seq.* 25, 31, 33

United States vs. Isham, 17 Wall, 496, 504 36

United States vs. Mellon, 279 Fed. 910, 914-5 55

United States vs. Phellis, 257 U. S. 156 ..... 37, 38, 39, 43, 44, 45

No. 263.

n the Supreme Court of the United States

October Term,

1923.

HARRY H. WEISS, Collector of Internal Revenue,

Petitioner,

vs.

JOHN G. WHITE,

Respondent.

N WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

The facts are undisputed. The only thing in question is the proper interpretation thereof, and what is e law applicable thereto. Indeed, the applicable law , we think, determined by the interpretation of the cts.

It is conceded that all of the preliminary steps have en taken, enabling respondent to maintain the action.

Two taxes are involved: In April, 1916, The National Acme Manufacturing Company paid a stock dividend of 100 per cent. Respondent was compelled to pay come tax upon this dividend. Petitioner admits that is was erroneous and that respondent is entitled to ve a judgment for the amount he was so compelled pay, with interest. Petitioner states the amount that thinks to be the principal sum to which respondent is

entitled because of the income tax paid on this stock dividend. We have not paused to consider whether this amount is correctly stated, because it is a mere matter of arithmetic, which can be easily agreed to, or if not agreed to, determined by the Court from the agreed facts.

This part of the case is entirely ignored in the brief of petitioner.

Two cases are being heard together, Numbers 262 and 263. This is No. 263. No. 262 is *Harry H. Weiss, Collector of Internal Revenue, Petitioner, vs. Louis Stearn.* These cases differ in two respects:

First: In the *Stearn* case there is no question about the stock dividend of April, 1916. As just remarked, whatever may be the decision as to the other part of the case, respondent is entitled to recover the tax he had to pay because of this stock dividend.

The second difference is that in the *Stearn* case issues were joined and the case was decided on an agreed statement of facts. In the instant case the petition set forth all the facts and the case was determined on a motion by respondent for a judgment on pleadings, which was granted. We believe the petition in the instant case sets forth the facts more at large than is done in the agreed statement of facts in the *Stearn* case, and we therefore, like the Solicitor General, use the record in this case.

The real dispute arises out of a transaction had in November and December, 1916, and this, in its turn, depends, we think, upon the interpretation of an agreement, a copy of which is attached to and made a part of the plaintiff's petition. Before the transaction The National Acme Manufacturing Company was an Ohio corporation. It had stock authorized and issued to the

amount of $5,000,000.00, divided into shares of the par value of $100.00 each. It had assets, excluding good will and patents, of a value of at least $10,000,000.00. This good will and patents were supposed to be of great value. The earnings of the company during the year 1916 approximated $5,000,000.00. During the year 1915 they were approximately $2,500,000.00, and during the three years prior thereto, approximately $500,000.00 to $800,000.00 per annum. (Record, p. 11). It was not a war bride. Its business consisted of manufacturing and selling screw-making machines under the patents owned by it, and of manufacturing and selling screws made by these machines. After the completion of the transaction The National Acme Manufacturing Company ceased to exist, but instead, The National Acme Company had come into existence, an Ohio corporation, having the same corporate powers and purposes as The National Acme Manufacturing Company, with a captial of $25,000,000.00, divided into shares of the par value of $50.00 each. It had exactly the same property and the same liabilities, neither more nor less than The National Acme Manufacturing Company, which property was devoted to the same purposes as it had been when it was the property of The National Acme Manufacturing Company. The process by which this change occurred it is, which gives rise to the question in the case. This transformation occurred through, and in pursuance of, the agreement, a copy of which is marked "Exhibit A" and attached to respondent's amended petition.

The question chiefly depends upon the interpretation of paragraphs of the agreement numbered First, Fourth and Fifth.

We pause here to point out four errors made in the brief of petitioner. As they are several times re-

peated, importance seems to be attached to them. On pages 9 and 10 of petitioner's brief, it is stated:

> "Of course, it is apparent that the purpose of Eastman, Dillon & Company, the purchasers, was to become the owners of a half interest in a very profitable business, and we all know that one who holds fifty per cent. of the stock of a corporation practically controls it, where the other half is held by numerous stockholders."

And on page 10 it is stated that they (Eastman, Dillon & Company) were purchasing the company for the purpose of reorganizing it and placing themselves in control.

And again, pages 19 to 20, speaking of the new corporation, it is said:

> "The real control had passed from him and those with whom he had been associated, and gone to the men who had invested in the enterprise $7,500,000.00 in cash."

(1) It would be something unusual for New York brokers, for the purpose of acquiring a half interest in the business, to invest $7,500,000.00 in an Ohio business into which a very considerable amount of water had just been injected.

(2) Eastman, Dillon & Company confessedly did not invest a dollar in the enterprise. The $7,500,000.00 were paid to the old stockholders. Nothing was taken out of the enterprise by the transaction, not a penny was added to it.

(3) Eastman, Dillon & Company did not acquire control of the business, and the suggestion that they did, because they would hold fifty per cent. of the stock in one ownership, while the old stockholders were numerous, is quite evidently inaccurate in view of a pro-

vision which we shall point out in analyzing the agreement giving Eastman, Dillon & Company the power to market their half of the stock at once, while the depository was not to give the old stockholders their stock until the 31st of May following. As a matter of fact, Eastman, Dillon & Company's stock was all marketed long before the stock certificates were delivered on the 31st of May to the old stockholders. The contract provides that the old stockholders shall have control of the board of directors, and that the old executives shall remain in office and the management be unchanged.

(4) The statement that Eastman, Dillon & Company had at some time during the transaction the ownership of all the stock is equally inaccurate.

That these are errors we think will sufficiently appear from the examination of the agreement which we are about to make.

W. D. B. Alexander, A. W. Henn and E. C. Henn, stockholders, officers, directors and managers of The National Acme Manufacturing Company, and the other stockholders of that Company, were called "Vendors," and Messrs. Eastman, Dillon & Company were called "Vendees." Upon these names, and the first part of the first sentence in Paragraph First, the whole claim of the petitioner stands. We quote the pertinent part:

> "The Vendors agree to and will sell all their said shares of common capital stock to, and the Purchasers agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, *subject to the terms of this agreement*, at and for the price of Three Hundred Dollars ($300.00) per

share, payable, one half in cash and one half in securities, *as hereinafter set forth;*" (Record, p. 10)

The petitioner entirely ignores the words italicized.

By Paragraph Third (Record, pp. 11-12), the stockholders agree to deliver to The Cleveland Trust Company, as depositary, certificates of all their stock, endorsed in blank, and subject to the terms of the agreement, and to constitute *the Vendors*, or a majority of them, attorneys-in-fact or proxies of the stockholders, to vote the stock in such way as may be necessary to carry out the purposes thereof. If the transaction was merely a sale by the stockholders of the old company of all their stock to Eastman, Dillon & Company, it is obvious that it would be Eastman, Dillon & Company who would vote the stock, for the stockholders would have ceased to be stockholders. Upon the deposit of at least 80 per cent. of all the outstanding stock, the purchasers were to deposit with The Cleveland Trust Company $7,500,000.00.

By the fourth clause (Record, p. 12), all parties to the agreement, both the so-called purchasers and vendors, that is to say, the stockholders of the Manufacturing Company and Eastman, Dillon & Company, agree to cause to be incorporated, under the laws of Ohio, a Manufacturing Company with similar powers to those of The National Acme Manufacturing Company, under the corporate name of The National Acme Company, that Company to have an authorized capital stock of $25,000,000.00 of common stock, divided into 500,000 shares of the par value of $50.00; that on the organization of such corporation, the purchasers and vendors, that is to say, the old stockholders of the Manufacturing Company, and Eastman, Dillon & Company, were to cause such proceedings to be had by the new Company

that it should purchase all the property and assets of every kind whatsoever of the Manufacturing Company, including its good will, and subject to all its liabilities, which are to be assumed by the new Company and paid as they mature, in consideration of the issue by the new Company of $25,000,000.00 of stock.

We pause here to remark that if title to all of the stock of The National Acme Manufacturing Company had been purchased by Eastman, Dillon & Company, it would have been they alone who would have incorporated the new Company.

The purchasers and vendors, that is, the old stockholders and Eastman, Dillon & Company, will use their best efforts to cause the Manufacturing Company to sell all its assets, including the good will, to the new Company for the capital stock of the newly organized Company, and the two together, that is, the old stockholders and Eastman, Dillon & Company, will cause this stock to be issued to The Cleveland Trust Company, depositary, to be held and distributed as provided in Paragraph 5.

We stop here to call attention to the fact that Eastman, Dillon & Company and the old stockholders are here treated as being stockholders of the Manufacturing Company, and as constituting together the entire body of stockholders of the Manufacturing Company, for, of course, nobody but the stockholders of the Manufacturing Company had any voice in determining whether that Company should sell its property and what it would take therefor. Were it true, as contended by the defendant, that all of the stock in the old Company had been purchased by Eastman, Dillon & Company, they alone would have possessed the power to compel the Manufacturing

Company to sell its assets to the new Company and to make the stipulation that the stock in the new Company should be issued to The Cleveland Trust Company, depositary. It is clear then that title to half of the stock of the old Company did pass to Eastman, Dillon & Company, who enjoyed all the rights arising therefrom, but not for a single instant did title to the other half of the stock of the old Company pass to Eastman, Dillon & Company, and not for a single instant did they enjoy or exercise any control over that half.

From this it is clear that in some way, by the terms of the agreement, Eastman, Dillon & Company are to become stockholders of the Manufacturing Company, and it is further clear that in some way, under the agreement, the old stockholders are to become stockholders of the new Company before the transfer is made.

We also call attention to the evident value placed upon the good will of the manufacturing company. The contract is careful to provide that in the property and assets to be transferred shall be the good will, and to retain that good will the name of the new company, "The National Acme Company," is to be as near to the name of the old company, "The National Acme Manufacturing Company" as possible.

The fifth clause (Record pp. 13-14) provides for what The Cleveland Trust Company shall do, and summarizing only the parts which are applicable to the transaction as it occurred, because all the stockholders of the Manufacturing Company did deposit their stock, The Cleveland Trust Company was first of all to transfer to Eastman, Dillon & Company, or their order, one-half of the stock of the new Company, to pay to the old stock-

holders of the old Company, $7,500,000.00 of cash, which works out $150.00 a share, but to retain the other half of the stock of the new Company with the voting power, until the 31st of May, 1917, at the end of which time it is to issue the other half of the stock of the new Company to the old stockholders, and this works out five shares of the new Company for each one share then owned by the old stockholders after transferring half of their stock to Eastman, Dillon & Company and the same number of shares to Eastman, Dillon & Company for the shares of stock in the old Company owned by them. We point out here that Eastman, Dillon & Company get their stock at once, while the old stockholders do not get their stock until the 31st of May, 1917, thus enabling Eastman, Dillon & Company to market their stock at once, while the old stockholders cannot market their stock until the 31st of May, 1917, five months after Eastman, Dillon & Company have got their stock, and that the half of the stock issued to Eastman, Dillon & Company has only four directors, while the half of the stock issued to the old stockholders has five directors, thus securing to the old stockholders the control of the corporation.

Further carrying out this last purpose, the sixth clause of the agreement, (Record, page 14), provides that the vendors being the active executive officers of The National Acme Manufacturing Company in the management of its business, agree to accept and retain, if elected thereto, for a period of five years after its organization, the same offices or positions which they held in the old company,

> "It being the desire of both parties hereto that the present management of the business be not interfered with by its transfer to the new company."

Still carrying out this purpose of securing to the old stockholders the control of the new corporation, Clause 7, (Record, page 14), provides:

> "Seventh: The purchasers and vendors will, in the organization of the new company, cause its regulations to provide for a board of directors nine in number, of whom four shall be nominated by them and five by the vendors."

Still further carrying out the scheme of enabling Eastman, Dillon & Company to market their stock, the eighth clause (Record, page 14) provides:

> "The purchasers and vendors further agree that they will cause the new corporation to make application for and use their best efforts to have its stock listed upon New York, Boston and Cleveland stock exchanges, and the vendors will co-operate with them therein."

Until Eastman, Dillon & Company became interested in this enterprise, the old stockholders had felt no necessity of having the stock listed on any stock exchange or of having the facilities to market the stock afforded by such listing.

The tenth clause, (Record, page 15) provided that no dividends should be paid between the 1st of January, 1917, and the 31st of May of the same year.

This agreement was carried out. The necessary corporate action was taken by each Company to that effect. The National Acme Manufacturing Company transferred all its assets, including patents and good will, to the new Company, and received therefor, through the depositary, the $25,000,000.00 of stock of the new Company. Eastman, Dillon & Company paid the $7,500,000.00 cash and the new Company assumed all the liabil-

ities of the old Company and acquired all its assets. Half the stock of the new Company was issued to Eastman, Dillon & Company and half the stock was issued to the old stockholders, together with the $7,500,000.00. No dispute arises out of the cash payment. This is conceded to be income, and the income tax arising therefrom has been paid without protest. But the question is, what is the nature of the remaining part of the transaction.

Our contention is that, looking through all the forms and machinery, the real transaction is this: The old stockholders sold half their stock to Eastman, Dillon & Company for $7,500,000.00, and deposited their stock, transferred in blank, with the depositary, subject to this agreement. Thereby Eastman, Dillon & Company became owners of half the stock of the Manufacturing Company and the old stockholders remained the owners of the other half of the stock of the Manufacturing Company. Then the two sets together, thus constituting the whole body of the stockholders of the Manufacuring Company, organized the new Company, and the two sets together constituting the whole body of stockholders of the old Company as such, through the corporate action agreed to be taken by this agreement of the 8th of November, transferred all its assets to the new Company for all the stock of the new Company and its assumption of, all the debts of the old Company. The stockholders of the old Company having thus become the owners of all the stock of the new Company, and it being part of the agreement that this stock shall be divided ratably among the stockholders of the old Company, half of this stock went to Eastman, Dillon & Company, or their nominees, they having become the owners of half of the stock of the old Company. Half of it, of course, went to the

old stockholders of the old Company. This being the nature of the transaction, Eastman, Dillon & Company on the 1st of January, 1917, for their half of the stock of the old company, got half of the stock of the new company or five new shares for one old, and the old stockholders, for each share of the half of the stock of the old Company which they owned, after selling the other half to Eastman, Dillon & Company, got five shares of the new Company, the new Company having exactly the same powers and the same purposes as the old Company, and exactly the same assets and the same liabilites. As a consequence, by this part of the transaction there was neither gain nor loss. Each stockholder simply had a certificate for a larger number of shares than they had before.

There has been no segregation of any of the assets of either the old Company or the new Company, no stock issued against any part of the assets of the old Company or the new Company, but the entire assets of the old Company, without addition or diminution, which before was the property of all the stockholders of the old Company, became the property of all the stockholders of the new Company, and represented by all its stock.

As averred in the petition, and as applicable to the respondent's case, after selling half of respondent's stock to Eastman, Dillon & Company, respondent had left $33,500.00 par value of the stock in the Manufacturing Company. Then for this, he received certificates for $167,500.00 of the par value of the stock of the new Company, evidencing that respondent owned 167,500/25,000,000 of exactly the same property of which, after the sale to Eastman, Dillon & Company of half the stock, he had owned 33,500/5,000,000. If 167,500/25,000,000

be reduced to the denomination of 5,000,000ths, it will be seen that respondent owned 33,500/5,000,000 of the property of the new Company, and as no new funds or property went into the new Company, after the sale to Eastman, Dillon & Company of half the stock, and after getting the stock of the new Company, he had only 33,500/5,000,000 of exactly the same property which he had before he received the certificates for stock, being exactly the same interest in exactly the same property which he had in the old Company. This being true, on the law as we think it is settled by the rulings of Courts, and by the provisions of the amendment to the Constitution of the United States, as interpreted by the courts, respondent derived no income from the exchange of certificates for 33,500/5,000,000 in the old Company for certificates for 167,500/25,000,000 in the stock of the new Company.

Exactly the same result, however, may be reached by another line of reasoning, namely: Treating it as a sale to Eastman, Dillon & Company of the entire stock for $7,500,000.00 of cash and $12,500,000.00 of stock of the new Company, the only profit obtained was from the payment of the cash, for half the stock of the new Company was of precisely the same value as half the stock of the old Company, represented exactly the same assets, the same liabilities, devoted to the same purposes as before, and that hence, so far as the old stock was paid for by the new stock, no profit was made, no gain received, and hence no income.

Taking either line of reasoning,—there was no segregation as to the old stockholders of one-half of their stock of any part of the assets, which all still remained in the corporation, devoted to the same uses and

purposes as before, subject to corporate control, without any power on the part of the owners of the stock to segregate any part thereof without corporate action. We think it is perfectly clear that if the net assets of the old Company were not equal to the par value of the stock of the new Company, issued in payment for such assets, that the stockholders of the new Company, in case of necessity, could be and would be called upon to pay the balance of their stock subscription.

It may further be remarked that the old and the new stock were the same kind of stock, both being common stock.

In applying the law to these facts, we wish to lay emphasis upon certain facts:

(1) The old stockholders had no option as to taking cash, or part cash and part securities. Everyone who came under the agreement had to accept $150.00 in cash *and* five shares of stock of the new Company.

(2) The old stockholders and Eastman, Dillon & Company, together, as stockholders of the old Company, were to cause the old Company to transfer all its property to the new Company.

(3) The old stockholders and Eastman, Dillon & Company, as stockholders of the new Company, were to cause the new Company to accept the transfer of the assets of the old Company for $25,000,000.00 of its stock and the assumption of the debts of the old Company.

(4) No new money or property went into the new Company. Its assets and liabilities were exactly the same as those of the old Company.

(5) No money or property was taken out of the old Company, but all its assets went into the new Company.

(6) The old and new Companies were both Ohio corporations, both had exactly the same powers and the same purposes. All the property of the new Company was devoted to exactly the same purposes and subject to the same corporate control as when it was the property of the old Company, and could not be segregated therefrom by any action of the respondent.

(7) At no time did Eastman, Dillon & Company have control of the entire stock, but throughout the transaction Eastman, Dillon & Company and the old stockholders, concurrently owned each one-half of the stock, first of the old, then of the new corporation.

(8) Eastman, Dillon & Company did not acquire control of the new corporation. That was reserved to the old stockholders by the provision that they could name five out of the nine directors, and that the old executive officers should retain their offices and the management remain the same for five years.

Let us see then what is the law applicable to such a state of facts. Of course, since the decision in *Eisner vs. Macomber*, 252 U. S. 189, it is clear that Congress cannot make that income which is not income; that any law which attempts to do that is unconstitutional, and if the statute, as applied to the facts in the case, tries to make that income which is not in fact income, then it is to that extent unconstitutional.

The case must be determined by the Constitution plus the Act of 1916, under which the rights of the parties became fixed. We are not, therefore, concerned with the provisions of the Act of 1918, though we think that

there can be little doubt that portions of that law are unconstitutional.

The Treasury Department ruled in accordance with our contention, in a letter addressed by Commissioner W. H. Osborn to A. G. Dickson, dated May 3, 1915.

See Corporation Trust Company's Income Tax Service for 1916, Paragarph 1779:

> "This office is in receipt of your letter of the 21st ultimo, amended by your letter of the 23rd, in which is presented the following proposition for ruling of this office:
>
> 'A corporation having a capital stock of $500,000 has accumulated a surplus of $500,000 in addition to paying handsome dividends upon its capital stock. This company proposes to sell, or rather transfer to a reorganized company in which the stockholders and their proportionate interests are the same, all of its assets and good will for $5,000,000 par value of the second company's capital stock. The good will involved in the above proposition has been created entirely by the first company, and the earning capacity of the first company would appear to justify the suggested transaction.'
>
> In reply to your inquiry as to whether or not the difference in the nominal par values of the stocks of the two companies will be treated as taxable income, you are informed that the value of the tangible assets in this case is that represented by the original capital and the surplus of the first company or $1,000,000. Whatever value the business and properties had over $1,000,00 was the value of the good will. Good will is an intangible asset subject to neither appreciation nor depreciation in so far as taxable income is concerned. The conversion of good will into any form of assets other than cash or its equivalent does not constitute income.

In the case cited the $5,000,000 capital stock issued in payment for the assets (tangible and intangible) of the first company is in fact of no greater actual value than is that of the $500,000 of the first company, for the reason that in each case the value of the stock is based upon and supported by the same assets, and until the stock issued by the purchasing or reorganized company in payment for the assets of the first company is converted into cash or its equivalent, no taxable income will have been realized from the transaction. In other words the excess of the nominal par value of the stock issued in payment for assets, over the nominal par value of the stock of the selling company, the stock in both cases being supported by the same assets, does not constitute income within the meaning of the Federal income tax law."

After this decision was made, on the 9th of September, 1916, the Treasury Department reversed this ruling by letter from Commissioner W. H. Osborn to A C. Kahn, but prefaced their reversal by saying:

"In reply your attention is called to Treasury Decision 2274 (Paragraph 1205), a copy of which is herewith enclosed. This decision, you will observe, modified the ruling made in the letter addressed to Mr. Dickson; in fact, according to the last paragraph of this decision, 'all rulings, or parts of rulings, heretofore made, which are in conflict herewith, are hereby revoked.' "

Corporation Trust Company, Income Tax Service, 1917, Par. 1217.

Turning now to Treasury Decision 2274, which is thus the basis of the reversal, we find it to be as follows:

"Stock dividends paid from the net earnings or the established surplus or undivided profits of

corporations, joint stock companies or associations, and insurance companies are held to be the equivalent of cash and to constitute taxable income under the same conditions as cash dividends."

Corporation Trust Company, Income Tax Service, 1917, Par. 1205.

This ruling of the Treasury Department, of course, was overruled by the *Macomber* case, and hence the whole basis for the ruling of September 9, 1916, disappears. But, it is important to thus learn that the basis of the contention made in this case by the Government is an opinion of the Department, overruled by this Court, and that in the opinion of the Department in both rulings the transaction is merely a stock dividend.

It is, of course, settled by repeated decisions of both the inferior Federal Courts and this Court that an increase or a decrease of the value of the assets of a corporation is not an increase or a decrease of income of the stockholder until some of the assets of the corporation have been segregated from the property of the corporation and distributed among the stockholders, either in cash or its equivalent, so that it becomes the individual property of the stockholder.

It is impossible to add to the luminous opinion of this Court in *Eisner vs. Macomber,* 252 U. S. 189, as to what is income and when it becomes taxable income, and also to the opinion in *Towne vs. Eisner,* 245 U. S. 418, which is declared by the decision in *Eisner vs. Macomber* not to have been based on the special circumstances of the case, but upon the meaning of the word "income" and the language of the Sixteenth Amendment to the Constitution.

We hope the Court will forgive us for our extensive quotations from the opinion in the *Macomber* case, as it states more concisely and forcibly than we can what we think is the reasoning controlling the case under consideration.

This Court says:

> "In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised."

Again:

> "We find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence vs. Howbert*, 231 U. S. 399, 415; *Doyle vs. Mitchell Bros. Co.*, 247 U. S. 179, 185)—
>
> 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle* case, (pp. 183, 185).
>
> Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy."

Then, after saying that the Government placed chief emphasis upon the word "gain," but overlooked or mis-

conceived the significance of the next three words "derived-from-capital";—"the *gain-derived-from-capital.*"

"Here we have the essential matter: *not* a gain *accruing* to capital, not a *growth* or *increment* of value in the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being '*derived,*' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal:—*that* is income derived from property. Nothing else answers the description.

The same fundamental conception is clearly set forth in the Sixteenth Amendment—'incomes, *from* whatever *source derived*'—the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the Constitution." (The italics are the italics of the Court.)

Again:

"Certainly the interest of the stockholder is a capital interest, and his certificates of stock are but the evidence of it. They state the number of shares to which he is entitled and indicate their par value and how the stock may be transferred. They show that he or his assignors, immediate or remote, have contributed capital to the enterprise, that he is entitled to a corresponding interest proportionate to the whole, entitled to have the property and business of the company devoted during the corporate existence to attainment of the common objects, entitled to vote at stockholders' meetings, to receive dividends out of the corporation's profits if and when declared, and, in the event of liquidation, to receive a proportionate share of the net assets, if any, remaining after paying creditors. *Short of liquidation, or until dividend declared, he has no right to withdraw any part of either capital or*

profits from the common enterprise; on the contrary, his interest pertains not to any part, divisible or indivisible, but to the entire assets, business, and affairs of the company. Nor is it the interest of an owner in the assets themselves, since the corporation has full title, legal and equitable, to the whole. *The stockholder has the right to have the assets employed in the enterprise, with the incidental rights mentioned; but, as stockholder, he has no right to withdraw, only the right to persist, subject to the risks of the enterprise, and looking only to dividends for his return. If he desires to disassociate himself from the company he can do so only by disposing of his stock.*" (Our italics.)

"For bookkeeping purposes, the company acknowledges a liability in form to the stockholders equivalent to the aggregate par value of their stock, evidenced by a 'capital stock account.' If profits have been made and not divided they create additional bookkeeping liabilities under the head of 'profit and loss,' 'undivided profits,' 'surplus account,' or the like. *None of these, however, gives to the stockholders as a body, much less to any one of them, either a claim against the going concern for any particular sum of money, or a right to any particular portion of the assets or any share in them unless or until the directors conclude that dividends shall be made and a part of the company's assets segregated from the common fund for the purpose.* The dividend normally is payable in money, under exceptional circumstances in some other *divisible* property; and when so paid, then only (excluding, of course, a possible advantageous sale of his stock or winding-up of the company) does the stockholder realize a profit or gain which becomes his separate property, and thus derive income from the capital that he or his predecessor has invested." (Our italics.)

This Court then points out that mere book entries do not constitute a gain for the stockholder, nor give rise to taxable income on the part of the stockholder; that they do

> "not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each share.
>
> A 'stock dividend' shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. *Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.*
>
> *The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment.*" (Our italics.)

Again:

> "We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital, at the same time shows he has not realized or received any income in the transaction."

This Court then says that if he sells, and when he sells, whether dividend stock or original stock, at a profit, he *then* has a taxable income, but that whether he sells dividend stock or original stock,

> "he necessarily disposes of a part of his capital interest, just as if he should sell a part of his old stock, either before or after the dividend. What he retains no longer entitles him to the same proportion of future dividends as before the sale. His part in the control of the company likewise is diminished."

Again, another most important remark of this Court:

> "Yet, without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

Again:

> "We have no doubt of the power or duty of a court to look through the form of the corporation and determine the question of the stockholder's right, in order to ascertain whether he has received income taxable by Congress without apportionment.

But looking through the form, we cannot disregard the essential truth disclosed; ignore the substantial difference between corporation and stockholder; treat the entire organization as unreal; look upon stockholders as partners, when they are not such; treat them as having in equity a right to a partition of the corporate assets, when they have none; and indulge the fiction that they have received and realized a shart of the profits of the company which in truth they have neither received nor realized. We must treat the corporation as a substantial entity separate from the stockholder, not only because such is the practical fact but because it is only by recognizing such separateness that any dividend—even one paid in money or property—can be regarded as income of the stockholder. Did we regard corporation and stockholders as altogether identical, there would be no income except as the corporation acquired it; and while this would be taxable against the corporation as income under appropriate provisions of law, the individual stockholders could not be separately and additionally taxed with respect to their several shares even when divided, since if there were entire identity between them and the company they could not be regarded as receiving anything from it, any more than if one's money were to be removed from one pocket to another."

This Court then says that it does not regard market prices of stock, based upon sales before and after the stock dividends, of any significance, saying:

"But we regard the market prices of the securities as an unsafe criterion in an inquiry such as the present, when the question must be, not what will the thing sell for, but what is it in truth and in essence."

Again this Court says:

> "But an actual cash dividend, with a real *option* to the stockholder either to keep the money for his own or to reinvest it in new shares, would be as far removed as possible from a true stock dividend, such as the one we have under consideration, where nothing of value is taken from the company's assets and transferred to the individual ownership of the several stockholders and thereby subjected to their disposal."

Eisner vs. Macomber, 252 U. S. 189, 206, *et seq.*

Counsel for the petitioner seem to have misunderstood some remarks in this case. It is too well settled to require any citation of authorities to establish the fact which is impliedly questioned by the petitioner, viz. that a certificate of stock is merely evidence of ownership by the stockholder of a corresponding undivided interest in the property of the corporation, but most of their reasoning and especially that in the third part of their brief urging the Massachusetts cases seems to be based upon a denial of this established principle.

The case of *United States vs. Alpha Portland Cement Co.*, 242 Fed. 978, s. c. 257 Fed. 432, 261 Fed. 339, is instructive. The District Judge said in the 242 Fed.:

> "From the viewpoint of the taxing authorities the defendant had property which it had acquired at a price, and which it disposed of at an enhanced price, thereby reaping a taxable profit. From the viewpoint of the defendant, the whole transaction was nothing more than a revaluation of the property. The retort of the United States is that the defendant declared it had made a sale of its property at an advance in price, that it received payment at an advanced price, and that it could not have done what it did do, nor have enjoyed the benefits of the transaction, unless the transaction

had in fact been what on its face it was. The defendant in consequence will not be heard to deny that it received the profit it thus is shown to have received."

The defendant company in 1909 bought the Buckhorn property for $415,000.00. It also bought for $416,627.27 a number of shares of the stock of the Catskill Cement Company, together with Letters Patent No. 677,870 issued for an invention. It took title in the name of its President. The defendant company had a capital stock of $2,000,000.00. A plan of reorganization was adopted. This involved, as part of the details, the organization of a subsidiary company, having a capitalization of $2,001,000.00, the $1,000.00 issued for cash and $2,000,000.00 for property. The cash stock was issued to individuals, to whom the stock was nominally issued. The real owner of it was the defendant company. The subsidiary company, the Cement Manufacturing Company, issued its stock to the par value of $2,000,000.00 for a transfer of the Buckhorn property. The $2,000,000.00 of the stock of the subsidiary company went to the defendant company and was distributed by it among its stockholders as a property dividend. The Cement Manufacturing Company and the original company, now the defendant company, were then merged or consolidated under the name of the latter company, and the consolidated company was given a capital stock of $10,000,000.00—this in the form fo $2,000,000.00 preferred and $8,000,000.00 common stock. The $2,000,000.00 of preferred stock was issued to the Cement Manufacturing Company stockholders and the $8,000,000.00 of common to the stockholders of the original defendant company, in exchange for the stock they held of their respective companies. This brought the assets of

the company, as the books of account had been kept, up to the total asset value, as carried on the books of $868,315.01. The Court said:

> "It may help to clarify our view by stating separately the conditions (1) as affecting stockholders; (2) as affecting the company; (3) the transaction as it was; and (4) the transaction as it was made to appear to be.
>
> 1. The stockholders at first held certificates of stock representing shares in the assets of the original defendant company. * * * These assets had been acquired by the company at a cost of $868,315.01, and had been so entered on the books of the company. The certificates of stock, as a mode of expressing the proportionate shares of the stockholders in the assets, represented the entire holdings of the company by the figures $2,000,000, or this was given as the nominal par value of the total number of ownership shares into which its ownership was divided. When the transaction was done, the stockholders had precisely what they had before, so far as ownership of assets goes. The books of account had been rewritten, so as to show that the assets had cost the company $10,000,000 instead of $868,315.01, and the certificates of stock had been reprinted, so as to represent the total ownership, in which the stockholders shared, by the figures $10,000,000 instead of $2,000,000. Intermediately the stockholders, instead of holding certificates of stock in the Alpha Portland Cement Company for $2,000,000, representing the entire ownership in which they shared, held also for an instant of time certificates of stock in the Cement Manufacturing Company for $2,001,000, representing the entire ownership in which they shared the latter company.
>
> 2. At the end of the transaction, the defendant company had precisely what it had before. Its bookkeeping figures had been changed as to the

value of its assets from $868,315.01 to $10,000,000, and there had been a like change in the figures of its capital stock account from $2,000,000 to $10,000,000. The Cement Manufacturing Company had intermediately enjoyed a transitory life of short duration.

3. *The real transaction was nothing more than effecting a reorganization of the defendant company, for the purpose of increasing its nominal capital, in the sense of changing the figures which represented its total stock issue.*

4. The transaction as it was made to appear to be was this: The Company owned the Buckhorn and other property already mentioned. It carried them upon its books at a cost value of $868,315.01. It sold them for $2,000,000, and reinvested the money received in the stock of the Cement Manufacturing Company. It then declared a dividend, payable, not in money, but in this stock of $2,000,000 representing the profit of $1,131,684.99 received on this sale, and the balance received through an enhancement in value of other assets. Its stockholders then exchanged this $2,000,000 of stock in the Cement Manufacturing Company for preferred stock of the defendant merged company of like nominal value."

United States vs. Alpha Portland Cement Co., 242, Fed. 978.

The case then went to the jury. A verdict was found for the Government. Motion for a new trial was filed. The Court at this time said:

"These substantial facts are that a corporation existed, the capital of which it was desired to have increased without any fresh contribution of capital being made by any one. The company owned a property which it had bought at a price, and which was carried on its books as part of its assets at its cost. The property possessed what may be called

the quality of elastic value. As such transactions are viewed, it could be considered as having a value of many times what had been paid for it. *The plan devised was to organize another company with the desired capital, and have the first company sell to the second the property, at a valuation equal to the capital of the latter, which paid for the propery by the issue of its stock.* The two companies were then merged into the present company, which, under the agreement of merger, was given the nominal capital it was planned to have, and the new company assumed all the obligations of the old. What actually and in fact resulted is too obvious to require statement. The bookkeeping result was, however, very different. The facts thus manufactured and made to appear were that the second company, by the formal action of its board of directors and its executive officers, offered to buy of the first company the property mentioned, at a cash price, for real money. This offer the first company, after like formal corporate action, accepted. A conveyance was made on the basis of this consideration having been paid and received. The books of the second company stated that it had paid actual money for the property. The books of the first company showed a corresponding receipt of the same moneys, and, in addition, showed a clear statement of the large profit which had accrued to it. In point of fact, at no time was a dollar handled by any one, or in sight. The facts were all manufactured bookkeeping facts."

The resemblance to the case at bar is obvious, and the difference between the two cases is all in favor of our contention. In our case, there are no bookkeeping recitals of a sale for cash or a receipt of cash. The bookkeeping entries are that the sale was for stock and the receipt was for stock and the preliminary agreement was for stock,—that the sale should be made for stock.

The resemblance between the two cases consists in the fact, on which alone the Government stands in the present case, that a sale was recited, but in the case at bar, the statement of the sale was accompanied by other terms, and qualified and explained by other words, which disclosed that it was not in fact a sale, but a reorganization of the Company.

The Court went on:

> "The argument of counsel for the United States, ably and successfully presented to the jury, was in effect that when a person says he has received moneys by way of profit or income, and states the amount which he has so received, and for what he received it, and the source from which it came, this is evidence against him, and justifies the finding that what he says is true, and that he did receive the profit which he says he received.
>
> This argument, so far as it goes, is unanswerable, and it went far enough to secure this verdict, and would go far enough to sustain it, *were it not for the fact that the mind staggers over giving sanction to a finding that something is true which we know is not true.*"

The Court then says:

> "No one is called upon to pay unless he has the wherewith with which to pay. If the law is construed with these grounds, indicating its policy, in mind, we must construe the words 'income received' as meaning actually received, and not to include something which exists merely as a figment of the imagination.
>
> With this construction given to the act of Congress, the common-sense conclusion is that the exacted tax is not payable."

The Court, while expressing the opinion that there was no taxable income derived from the transaction, yet

refused to order a new trial, to the end that the Government might have, in the reviewing court, whatever benefit might be derived from a verdict in its favor.

United States vs. Alpha Portland Cement Co., 257 Fed. 432, 434, *et seq.*

The case then came before the Circuit Court of Appeals. There the Court stated the facts to be that

> "during the year 1909 the defendant purchased certain properties, the legal title to which was taken in the name of its president, as trustee. Later in the same year, pursuant to a plan for increasing the capital stock of the defendant, these properties were conveyed by the trustee to a corporation known as the Cement Manufacturing Company, which had been formed for the express purpose of thus acquiring and using them in carrying out the recapitalization scheme. The consideration of the conveyance was the issuance by the latter company to the trustee of its entire capital stock, except a few shares necessary, under the laws of the state where the company was incorporated, to be held by the directors. The stock thus issued to the trustee was immediately transferred by him to the defendant, which in turn distributed it among its stockholders, share for share. Thereupon, in furtherance of the recapitalization plan, a merger was effected between the defendant and the Cement Manufacturing Company. For purposes of the merger, the value of properties so conveyed to the Cement Manufacturing Company (which constituted all of its assets) was fixed at the same figure as that at which the trustee had conveyed them to that company; also, before the stock was distributed among the defendant's stockholders it was formally valued by its directors at par. The par value of such stock greatly exceeded the price at which the property had originally been purchased by the defendant. The defendant did not include as income in the tax re-

turn, which it was required by law to make for that year, the apparent profit resulting from the difference between the price which it had originally paid for the properties and the price at which it had ostensibly sold them to the Cement Manufacturing Company. * * *

From the foregoing recital of facts, it is apparent that while, as a matter of form and of bookkeeping, the defendant did realize a very considerable profit during the tax year in question on the purchase and transfer of these properties, yet in reality it made no profit whatever. *The ultimate and real result of the various transactions was that the defendant purchased some properties at one figure, and in working out a plan of recapitalization valued them at a higher figure.* The intermediary corporation, to which the legal title of the properties was conveyed by the trustee, was brought into being by the defendant for the express purpose of working out the recapitalization plan, and ceased to exist as a separate entity after that plan had been carried out. The defendant was no richer after the alleged sale than it was before, notwithstanding the book entries, resolutions of directors, transfers of title, etc. Viewed in this light, we think that it needs no argument to demonstrate that the case falls within the principle of the decisions of the Supreme Court in *Southern Pacific vs. Lowe*, 247 U. S. 330, 38 Sup. Ct. 540, 62 L. Ed. 1142, and *Gulf Oil Corp. vs. Llewellyn*, 248 U. S. 71, 39 Sup. Ct. 35, 63 L. Ed. 133. Indeed, it cannot be distinguished on principle from the decision of this court in *Baldwin Locomotive Works vs. McCoach*, 221 Fed. 59, 136 C. C. A. 660. Under the above stated facts, considered as a whole, the defendant was therefore not liable for the tax which the government sought to recover in this suit."

We stop here to point out the importance of the italicized portion of this opinion in which the Court says

that the arbitrary value put upon the property for the purpose of carrying out the scheme of reorganization has no controlling significance. A similar action in the case at bar is relied upon by the Government, but is entitled to as little significance as in the *Alpha Portland Cement Company* case.

The Court then takes up the contention of the Government that because the evidence showed, by the bookkeeping entries, that a profit had been made by buying at one price and selling at an increased price, therefore it was a question for the jury, and hold that this evidence cannot be taken separate and apart from the rest of the evidence, which showed that these were mere bookkeeping entries, merely made for the purpose of carrying through the reorganization, and could not be detached; that, therefore, the District Court erred in not giving binding instructions to the jury to return a verdict in behalf of defendant, and reversed the judgment.

Alpha Portland Cement Co. vs. United States, 261 Fed. 339, 340, *et seq.*

We call attention to the significance of this holding as bearing upon the contention of the Government that the statement of purchase in the agreement of the 8th of November is controlling.

We now call attention to the two decisions of this Court referred to in this latter opinion.

Referring to the facts in the case at bar, it will be seen that there is no segregation of the assets of The National Acme Manufacturing Company. They remain together, in the language of the Supreme Court in the *Macomber* case, subject to the same purposes, to be used in carrying out the same objects as before, and without the interest of the plaintiff therein being in any way seg-

regated. As said by this Court in the *Macomber* case, there might be a dividend which would give rise to income, although it was not a cash dividend, if it was made by segregation of the assets of the Company. We may, therefore, distinguish those cases in which a corporation, having as part of its assets, shares in another Company, distributes those shares among its stockholders.

Peabody vs. Eisner, 247 U. S. 347.

In the last mentioned case, the Union Pacific Railroad Company, as part of its assets, owned stock of the Baltimore & Ohio Railroad Company. It declared a dividend of $3.00 in cash, $12.00 in par value of preferred stock of the Baltimore & Ohio, and $22.50 in par value of the common stock of the same company. This Court held that by this dividend, payable in stock of the Baltimore & Ohio Railroad, the plaintiff got income, saying,—

> "that this case is not ruled by our decision in *Towne vs. Eisner,* since the dividend of Baltimore & Ohio shares was not a stock dividend but a distribution *in specie* of a portion of the assets of the Union Pacific, and is to be governed for all present purposes by the same rule applicable to the distribution of a like value of money."

Peabody vs. Eisner, 247 U. S. 347, 349-50.

So in *Lynch vs. Hornby,* a Lumber Company sold part of its capital assets for money and divided that money among its stockholders by means of a dividend, and the Court held that the profit arising from the increase in value of the property thus turned into money and distributed among its stockholders, constituted taxable income.

Lynch vs. Hornby, 247 U. S. 339.

In each of these cases part of the assets had been segregated and thus diverted from the purposes of the corporation and divided among the stockholders.

On the other hand, in *Southern Pacific Co. vs. Lowe*, where the two corporations were in fact identical, *though in legal contemplation separate entities*, it was held that the allotment of stock did not create income.

Southern Pacific Co. vs. Lowe, 247 U. S. 330.

A case similar to the last in principle is *Gulf Oil Corp. vs. Llewellyn*. In that case, a subsidiary company and the holding company together constituted a single enterprise, carried on by the Gulf Oil Corporation, of producing, buying, transporting, refining and selling oil. The Gulf Oil Corporation took over, in January, 1913, all the earnings and surplus of the subsidiary companies. This Court says:

> "But disregarding the forms gone through, the result was merely that the petitioner became the holder of the debts previously due from one of its companies to another. It was no richer than before, but its property now was represented by stock in and debts due from its subsidiaries, whereas formerly it was represented by the stock alone, the change being effected by entries upon the respective companies' books. * * * It is true that the petitioner and its subsidiaries were distinct beings in contemplation of law, but the facts that they were related as parts of one enterprise, all owned by the petitioner, that the debts were all enterprise debts due to members, and that the dividends represented earnings that had been made in former years and that practically had been converted into capital, unite to convince us that the transaction should be regarded as bookkeeping rather than as 'dividends declared and paid in the ordinary course by a corporation.'"

Gulf Oil Corp. vs. Llewellyn, 248 U. S. 71, 72.

It is, of course, well settled that where there is doubt in the construction of a tax law, that these doubts should be resolved in favor of the taxpayer and against the Government. This Court said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen. *United States vs. Wigglesworth*, 2 Story, 369; *American Net & Twine Co. vs. Worthington*, 141 U. S. 468, 474; *Benziger vs. United States*, 192 U. S. 38, 55."
>
> *Gould vs. Gould*, 245 U. S. 151, 153.
>
> *Crocker vs. Malley*, 249 U. S. 223, 233, citing *Gould vs. Gould*, *United States vs. Isham*, 17 Wall, 496, 504.

We repeat that in the case at bar, the new corporation took over all the assets and liabilities of the old corporation and issued therefor its stock. No new assets went into the new corporation; no new liabilities were created. The old corporation went out of existence, its stock no longer existed, but there was substituted the stock of the new company. The purposes of the two corporations were the same; they were incorporated under the laws of the same state. It was part of the agreement that the managers of the old company should continue managers of the new company. The name of the new company was such as to retain the good will of the old. After the transaction was complete, as before, there was only one body of stockholders,

and their stock represented exactly the same property that had been represented by the old stock. The only difference was that the new corporation was capitalized for a larger amount, (all of the stock of which was issued at once for the old assets) and that the size of the shares was different. There was substantial identity between the old and the new corporation.

The rule deducible, we think, from these cases is, that if there is a substantial identity between the two corporations, that nothing has been added, nothing has been substracted from its property; if the old corporation ends simultaneously with the beginning of the new corporation, both corporations have the same powers, are incorporated in the same State, are carrying on the same enterprise; if the interest of each stockholder remains the same in the new corporation as in the old; if there has been no segregation of profits, but all the profits still remain invested in the business, so that therefore the stockholder cannot dispose of any of his stock without diminishing his share in the corporation; that in such cases just stated, there has been no income derived. The pivotal point, as we see it, is: Has there been any segregation of the property of the corporation; has any stock been issued specifically for profits or for property representing profits, or as representing specific parts of the property of the corporation, so that by selling such stock thus segregated, the stockholder can realize his profit and preserve his proportional interest in the enterprise unimpaired? We do not think that any of the cases cited by counsel for petitioner in any way contravene this principle.

Counsel rely upon the cases of *United States vs. Phellis*, 257 U. S. 156; *Rockefeller vs. U. S.*, 257 U. S. 176; *Cullinan vs. Walker*, 262 U. S. 134.

Bearing in mind the facts and the principles just stated, let us examine these cases and their *ratio decidendi.*

Stating the facts in the *Phellis* case this Court said:

> "Each holder of the New Jersey Company's (the old company) common stock (including claimant), *retained his old stock* and besides received a dividend of two shares for one in common stock of the Delaware company (the new company), and the New Jersey corporation (the old company) retained in its treasury 6 per cent. debenture stock of the Delaware corporation (the new company) equivalent to the par value of its own outstanding common stock. * * * After the reorganization and the distribution of the stock of the Delaware corporation (the new company), the New Jersey corporation (the old company) continued as a going concern, and still exists. * * * It is not, however, in process of liquidation. It has received as income upon the Delaware company's debenture stock held by it, dividends to the amount of 6% per annum, which it has paid out to its own stockholders including the claimant. * * *" (page 167)

Then proceeding to reason upon these facts, this Court said:

> "The *common stock* of the *new company*, after its transfer to the old company and prior to its distribution, constituted assets of the old company which it *now held* to represent its surplus of accumulated *profits.*" (p. 170)

Thus stressing that the surplus of accumulated profits was segregated into the stock of the new company. In the case at bar there was no stock of the new company issued as against the surplus or accumulated profits, and there was no segregation of accumulated profits into stock. Each share of the *new stock* represented

exactly the same thing that each share of the *old stock* represented. This Court further said:

> "still however a common fund in which the individual stockholders of the old company had no separate interest. But when this common stock was distributed among the common stockholders of the old company as a dividend, then at once—unless the two companies must be regarded as substantially identical—the individual stockholders of the old company, including claimant, received assets of exchangeable and actual value severed from their capital interest in the old company, proceeding from it as the result of a division of former corporate profits, and drawn by them severally for their individual and separate use and benefit."

In the *Phellis* case, the old and the new corporation continued to exist side by side. They were not substantially identical. They were distinct corporations, intended to remain distinct corporations, and the stock of the new corporation represented exclusively the surplus of accumulated profits of the old company, and these had been severed from the capital interest in the old company. In the case at bar, contemporaneously with the distribution of the stock in the new company, the stock in the old company ceased to exist, and the old company ceased to exist. There was no severance of the stock and assets of the new company from the stock and assets of the old company. One represented the other instead of continuing to exist side by side.

This Court then rejected the use of the market value of the stock as an indication of whether or not there had been an income, and then proceeds to discuss the question of whether there was a substantial identity between the old company and the new company. This Court says that there was not a substantial identity be-

tween the two companies. Let us see what they point out as showing that there was not a substantial identity —but we pause here to remark that this portion of the reasoning of the Court would have been unnecessary had it not been true, in the opinion of the Court, that if there was a substantial identity between the old and the new corporation, then the result should have been different from what it actually was. The case therefore is a direct authority against petitioner's third claim that the mere fact of the intervention of a new company of itself creates income. This Court says:

> "The plan as thus proposed and adopted, and as carried out, involved the formation of a *new corporation* to take over the business and the business assets of the old; it was to be and was formed under the laws of a *different State*, which necessarily imports a different measure of responsibility to the public, and presumably different rights between stockholders and company and between stockholders *inter sese*, than before."

Then after saying that they would assume that there was no difference between the articles of association, the Court proceeds:

> "But the new company was to have authorized capital stock aggregating $240,000,000—nearly four times the aggregate stock issues and funded debt of the old company—of which less than one-half, ($118,515,900) was to be issued presently to the old company or its stockholders, leaving the future disposition of a majority of the authorized new issues still to be determined."

In the case at bar, all of the stock of the new company was issued at once to the old company to be distributed by it in exchange for the old stock. Proceeding the Court says:

> "There was no present change of officers or stockholders, but manifestly a continuation of identity in this respect depended upon continued unanimous consent or concurrent action of a multitude of individual stockholders actuated by motives and influences necessarily to some extent divergent."

In other words, the old and the new corporation continuing to exist side by side, the continuance of identity of stockholders and the management of the old and the new corporation depended upon what might be the divergent action of the members of the two corporations. A sufficient number of the stockholders of the new corporation, for instance, might sell their stock to introduce a majority of new stockholders in the new corporation, while the old stockholders retained their stock in the old corporation, or vice versa, and in either case, the two corporations continuing to exist side by side, there would be a diversity of interest, a diversity of membership, a diversity of control, a diversity of policy. In the case at bar the old corporation having ended there could be no transfer of stock in one corporation while stock in another corporation remained the same, there could be nothing but the ordinary change of membership of one and the same corporation, a change which, in *Eisner vs. Macomber,* was held to be no reason for declaring a stock dividend to be income. This Court proceeds:

> "In the light of all this we cannot regard the new company as virtually identical with the old, but must treat it as a substantial corporate body with its own separate identity, and its stockholders as having property rights and interests materially different from those incident to ownership of stock in the old company.
>
> "The findings show that it was intended to be established as such, and that it was so created in fact and in law. There is nothing to warrant us in

> treating this separateness as imaginary, unless the identity of the body of stockholders and the transfer *in solido* of the manufacturing business and assets from the old company to the new necessarily have that effect. But the identity of *stockholders was but a temporary condition, subject to change at any moment at the option of any individual.''*

Necessarily, in view of the ruling in *Eisner vs. Macomber,* this depends upon the continued existence of the two corporations, for, of course, where there is a stock dividend which was held not to create income, in *Eisner vs. Macomber,* there may be a change in the stockholders, dependent upon the will of any stockholder. Therefore, this in and of itself is not what the Court means, but what it does mean is that the identity of the stockholders in the still subsisting two corporations may be changed at will. Again, the Court lays stress upon the fact that the new stock represented only accumulated surplus. They say:

> ''It was a part of the purpose and a necessary result of the plan of reorganization, as carried out, that common stock of the new company to the extent of $58,854,200 should be turned over to the old company, treated by it as *assets to be distributed as against its liability to stockholders for accrued surplus, and thereupon distributed to them 'as a dividend.'* The assent of the stockholders was based upon this as a part of the plan.
>
> ''In thus creating the common stock of the new company and transferring it to the old company for distribution *pro rata* among its stockholders, the parties were acting in the exercise of their rights *for the very purpose of placing the common stockholders individually in possession of new and substantial property rights in esse, in realization of their former contingent right to participate eventually in the accumulated surplus.''*

Speaking of the stock of the new company, this Court said:

> "There was neither express nor implied condition, arising out of the plan of reorganization or otherwise, to prevent any stockholder from selling it; *and he could sell his entire portion or any of it without parting with his capital interest in the parent company, or affecting his proportionate relation to the interests of other stockholders,* whether he sold the new stock for money or retained it in preference, in either case when he received it he received as his separate property a part of the accumulated profits of the old company in which previously he had only a potential and contingent interest."

It will thus be seen that the entire *ratio decidendi* of this decision was predicated upon two propositions. The first and most fundamental, the continued existence of the old company after the new company was formed. It was part of the plan that the old company should continue to exist and to function. Second, that the stock in the new company was issued against surplus profits, thus segregating the stock representing surplus profits from the portion of the stock representing assets of the company that was not surplus funds, and enabling the stockholder, by selling the new stock, to realize upon his share of the surplus profits of the old company.

Upon these two facts are based the whole law and gospel of the decision in *United States vs. Phellis.*

We may deal more shortly with the other two cases which are reported together, *Rockefeller vs. The United States of America* and *The New York Trust Company, et al., vs. Edwards, Collector.* In these cases, as in the *Phellis* case, the old corporation and the new corporation continued to subsist side by side. In these cases,

as in the *Phellis* case, a certain part of the property was segregated and represented by the stock of the new Company. In the *Phellis* case, the surplus profits of the old Company were segregated. In the *Rockefeller* and *New York Trust Company* cases, certain of the tangible assets were segregated. In the *Rockefeller* case, as in the *Phellis* case, the stockholder, by selling his new stock, could realize upon that part of the assets which was thus segregated, without in any way taking anything from his ownership in the old company. In the *Phellis* case, as in the *Rockefeller* case, by the formation of the new company, a portion of the property of the old company was segregated from the remaining property of the old company and represented by the new stock. In the case at bar, there is no segregation. We insist that the reasoning of this Court in all three of these cases impliedly sustains our position; that it impliedly holds that there is no income, inasmuch as the new company is a substitution for the old company, as it takes its place in every respect as to property and as to stockholders, the stock representing the same assets, the same liabilities, and owned by the same individuals, so that there is no segregation of assets by the creation of stock against segregated assets, no creation of a body of new stockholders distinct from the body of old stockholders, no creation of a single stockholder who was not a stockholder of the old company and holding the new stock in exactly the same proportion as the old; so that after the transaction was complete, each stockholder having ceased to hold any old stock and holding only new stock, by virtue of his holding his new stock in the same proportion which *he had* formerly held the old stock, owned exactly the same proportion of the property of the new company as he had before.

The reasoning of this Court manifestly holds that when there is a substantial identity between the new company which has come into existence and the old company which has gone out of existence, and an identity of the stockholders and an identity of the proportionate ownership, that then no rights have been created, no income created, no income tax liability exists.

The last case in this Court cited by petitioner is *Cullinan vs. Walker*, 262 U. S. 134.

This too, we think, fails to assist petitioner. The facts in the case were that the Farmers Petroleum Company, a Texas corporation, was both a producing and a pipe line company. In 1915 it was dissolved under the Texas law. Trustees in liquidation were appointed. In 1916 the trustees organized two Texas corporations, The Republic Production Company, a producing concern, and The American Petroleum Company, a pipe line concern. To these corporations the trustees assigned, to the one, the producing assets, to the other, the pipe line assets, equal in value. From each they received $1,500,000.00 par value of stock and $1,500,000.00 par value of bonds, being the total issues. Suppose the transaction had stopped here and the trustees had distributed the stock and bonds pro-rata to the stockholders in the Farmers Petroleum Company. Very obviously the case would have been ruled by the *Phellis* and *Rockefeller* cases. As pointed out in those cases, the temporary identity of stockholders and officers would not necessarily last. In time the stockholders of each would change and the corporations become as divergent as if they had not had a common origin. But, as if to liken the case more closely to the *Phellis* case, the trustees did not stop here. They organized the American Republics Corporation under the laws of Dela-

ware, a holding company. To it the trustees transferred all the stocks of the two new Texas corporations, and from it they received $3,000,000.00 of the stock of the Delaware corporation, so that they held, at the same time, the $3,000,000.00 of stock of the Delaware corporation and the $1,500,000.00 of bonds of the Texas corporations. All this was distributed pro-rata among the stockholders of the Farmers Petroleum Company. The part of the decision here important is not quoted by the petitioner in their brief. We think it is the following:

> "The corporation, whose stock the trustees distributed, was a holding company. In this respect, it differed from Farmers Petroleum Company, which was a producing and pipe line company. It differed from the latter, also, because it was organized under the laws of another State. It is true that, at the time this Delaware corporation's stock was distributed, it held the stock of the new oil producing company and likewise the stock of the new pipe line company. *But the Delaware corporation was a holding company. It was free, at any time, to sell the whole, or any part of the stock in either of the new Texas companies and to invest the proceeds otherwise. By such a sale, and change of investments, all interest of the holding company in the original enterprise might be parted with, without, in any way, affecting the rights of its own stockholders.*" (Our italics).
>
> *Cullinan vs. Walker*, 262 U. S., 134, 137-8.

What we have just said as to the holdings of this Court suffices to dispose of the two Massachusetts cases cited by counsel for petitioner. In the *Osgood* case, stock in one corporation was exchanged for stock in another corporation.

The *Osgood* case was a case not of an income tax but of a tax on purchases. With great deference to that

learned court, it is difficult to follow the reasoning of the Supreme Court of Massachusetts when it indicates that the word "purchase" is a broader word than the word "sale." They seem to us to be correlative terms. Where there is a sale there must be a purchase. Where there is a purchase there must be a sale. In the *Osgood* case the petitioner owned 1,300 shares of the preferred and 1,000 shares of the common stock of the Draper Company, which had outstanding preferred stock of the par value of $2,000,000.00, and common stock of the par value of $6,000,000.00. This was exchanged for stock in the Draper corporation, all of whose stock was common and of the par value of $17,500,000.00, 2½ shares were given for each share of the common stock of the old company and 1¼ shares for each share of the preferred stock of the old company. The Court seems to lay some stress upon the fact of a change in the kind of stock, as they recur several times to the fact that the new stock was not of the same kind as the old stock. We are not able to determine whether this was, in the opinion of the Court, an essential part of the basis of the decision. Aside from this, the *ratio decidendi* was that the two stock corporations were different legal entities, and, therefore, that the exchange of the stock of one for that of the other was necessarily a purchase, regardless of the question of the actual identity of the two corporations. Under this reasoning, every re-organization of a corporation effected by means of organizing a new corporation would necessarily be a purchase and give rise to gain or income. This is a proposition which has always been repudiated by the Commissioner of Internal Revenue, has never been approved by the Federal Courts, and is repudiated by this Court, as indicated by the authorities already cited.

We think that to these may be added on this point *Southern Pacific Co. vs. Lowe,* 247 U. S. 330 and *Gulf Oil Corporation vs. Llewellyn,* 248 U. S. 71.

We do not cite these last two cases as authorities to any but the one proposition, as to whether the fact of the two corporations being distinct legal entities is sufficient of itself to create income as a consequence of the transfer of stock.

In the *Lowe* case the *Southern Pacific Company,* a Kentucky corporation, owned all the stock of the Central Pacific Railway Company, a Utah corporation. The Railway Company was the successor of the Central Pacific Railroad Company and acquired all its property, which constituted a part of a large system of railways owned and controlled by the Kentucky company. The predecessor of the Utah Company had leased its railroads to the Kentucky Company and this lease had been assumed by the Utah Company. The Kentucky Company, besides being sole stockholder, was in the actual physical possession of the railroads and all other assets of the Utah Company, and in charge of its operations under the lease. The result was that while the two corporations remained distinct legal entities, the dealings back and forth, between them, were substantially bookkeeping entries. The result was that the books of the Utah Company showed a large surplus, accumulated prior to January 1st, 1913, principally in the form of a debit against the Kentucky Company, which, at the same time, as sole stockholder, was entitled to any and all dividends that might be declared, and being in control of the Board of Directors, was able to and did control the dividend policy. Dividends were declared and paid, but the payment was only made by bookkeeping entries, which simply reduced the apparent surplus of the Utah

Company and reduced the apparent indebtedness of the Kentucky Company to the Utah Company by precisely the amount of the dividends. This Court held that these dividends were not income because of

> "the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control."
>
> *Southern Pacific Co. vs. Lowe,* 247 U. S. 330, 337.

The Gulf Oil Corporation was a New Jersey corporation. It owned all of the capital stock of the J. M. Duffie Petroleum Company, The Gulf Pipe Line Company, The Gulf Pipe Line Company of Oklahoma, The Indiana Oil & Gas Company and the Gulf Commissary Company. These were all separate and distinct corporations apparently under the laws of different States, separate and distinct legal entities. All these companies constituted a single enterprise, carried on by the Gulf Oil Corporation, of producing, buying, transporting, refining and selling oil. Between these subsidiary companies debts existed. All the funds had been invested in properties or were actually required to carry on the business, so that the debtor companies had no money available to pay their debts. Under these circumstances, such transaction was had that the result was merely that the Gulf Oil Corporation became the owner of the debts previously due from one of its companies to another. It was no richer than before, but its property now was

represented by stock in and debts due from its former subsidiaries, whereas formerly it was represented by the stock alone, the change being effected by entries upon the respective companies' books. This Court said:

> "It is true that the petitioner and its subsidiaries were distinct beings in contemplation of law, but the facts that they were related as parts of one enterprise, all owned by the petitioner, that the debts were all enterprise debts due to members, and that the dividends represented earnings that had been made in former years and that practically had been converted into capital, unite to convince us that the transaction should be regarded as bookkeeping rather than as 'dividends declared and paid in the ordinary course by a corporation.' "
>
> *Gulf Oil Corporation vs. Llewellyn*, 248 U. S. 71, 72.

May we, as illustrative of our thought, cite a somewhat analogous case: In earlier days it was not uncommon for monied men in the East to select some enterprising person to whom they entrusted their money, to go into the then new West and acquire property, sometimes mining claims by prospecting, sometimes by purchase, sometimes ranches, or other property, or to conduct business, the person so sent giving to each person who contributed money, a memorandum showing the amount of money contributed by each and by all, and stating that the money was to be invested in the acquisition of property and the conduct of business in the West, the title to be held by the person to whom the money was entrusted, and the properties and business to be managed by this person. If the enterprise was successful and the selected person was honest, from time to time he made proportionate remittances to the associates, in money or in property. These remittances

thus were segregated from the enterprises in the shape of properties, or industries, or business carried on by the Western representative. The interest of each associate remained the same in the enterprise, but what he thus received became his to deal with as he saw fit. Let us suppose that a time came when this Western representative desired to lay down the burden, and that he selected some person to take his place, and that this selection was assented to by his associates. The substitution of the one trustee for the other in this case would be made by conveyance from the first trustee to the second trustee. Such conveyance would not at all affect the interest, either as a whole or proportionately, of the *cestui que trusts*, the associates in the East, yet, on the reasoning of the *Osgood* case, there would be a purchase and a sale, because there would be a conveyance from one person to another person of the legal title to the properties and the enterprises, and, under the reasoning of petitioner in the third sub-division of its brief, if the property had increased in value, there would have been an income derived by the transfer from the one trustee to the other trustee. We concede that the relations of the trustee and the *cestui que trusts* in this form of enterprise are not identical with the relations of a stockholder and a corporation, but they seem to us to be sufficiently analogous to point the argument that the mere transfer from one corporation to the other corporation in the case at bar did not suffice to make a purchase and a sale, giving rise to realized income.

In the next place, the underlying thought of the Supreme Court in the *Osgood* case seems to be the same as that in *Tax Commissioners vs. Putnam*, 227 Massachusetts, 522, the reasoning of which was specifically repudiated by this Court in the *Macomber* case. Counsel

for the plaintiff in error overlooked what this Court said of the reasoning of the Supreme Court of Massachusetts.

As to the second Massachusetts case referred to, *Stone vs. Tax Commissioners*, the remarks already made in relation to the *Osgood* case apply, but in addition to that, it is clear that the two companies were not identical. The facts were that the complainants owned stock in the National Carbon Company, a New Jersey corporation. They exchanged this stock for stock in the National Carbon Company, Inc., a New York corporation. This seems to have been a corporation identical with the New Jersey corporation, having the same assets and liabilities and the same stockholders. Even the Massachusetts Court does not hold that any income arose out of this exchange, and this exchange is like the exchange in the case at bar, with the exception that in the case at bar the new corporation was incorporated under the laws of the same State as the old, had the same objects and the same management. Then the complainants exchanged their stock in the National Carbon Company, Inc., for stock in another New York company, called the Union Carbide & Carbon Corporation, but the latter company acquired not only the property of the National Carbon Company, Inc., but that of three other corporations engaged in manufacturing not only the same product as the National Carbon Company, Inc., but other similar products, and issued its stock in exchange not only for the stock of the National Carbon Company, Inc., but for the stock of the other three companies, so that the stock of the Union Carbide & Carbon Company represented an interest in the assets and liabilities of four companies instead of one. It was on this exchange that the Supreme Court of Massachusetts held that a gain

was made, and we think rightly, because, unlike the case at bar, the new corporation represented an altogether different enterprise, different property, different assets, different stockholders from the old.

The next case we shall refer to was decided by the District Court of the United States for the Western District of Pennsylvania at the May Term, 1919. This case was a sequel to the above cited case of *Gulf Oil Corporation vs. Llewellyn*, 248 U. S. 71. To refinance the Gulf Oil Corporation it was decided early in 1913 to issue a 100 per cent. dividend on the then outstanding shares *declared to be payable in cash, but payment to be accepted in stock*, such payment being made possible by a concurrent increase in capital stock, which increase was in part effected by the capitalization of surplus acquired by its subsidiaries prior to 1913 and taken over from them in 1913, and to dispose of an amount of such increase equal to the original outstanding stock, for cash, at par, the principal stockholders undertaking to accept the dividend in stock, and to purchase their *pro rata* share of the new stock; and, further, the majority stockholders undertook to purchase for cash, at par, so much of the 100% new issue as might be declined by minority stockholders. The plan was put through, the holders of all but 1,740 shares accepting stock in payment of the dividend, and subscribing for their *pro rata* share of the new stock at par. Thus did the defendant.

> "Suit was for recovery of an income tax of $71,301 from the defendant, on the ground that the dividend, though paid in stock, was actually a cash dividend."

The resemblance to the case at bar will be seen. The dividend was called a cash dividend and was declared to be payable in cash, but payment to be accepted in stock,

as on the supposition in the case at bar that it was an actual sale to Eastman, Dillon & Company part of the payment was to be in stock, as to which there was no option whether it should be stock or cash. The Court says:

> "It is clear that if the resolution declaring the dividend in question, had provided for the payment of the dividend in stock, the dividend would not have been taxable. It is also clear that the defendant received payment of the dividend in shares of stock, *and that he did this pursuant to an agreement made prior to the declaration of the dividend, which agreement was communicated to the corporation before that declaration was made.*"

> "After the transaction, the defendant had two shares to represent the interest in the same property, which prior thereto was represented by one. After the transaction, there were twice as many shares of the corporation in the hands of stockholders as there were before. The corporate assets had not been diminished by the transaction. Therefore, for two shares which defendant possessed at the close, there was for him the same value as for one share represented at the beginning. It was fair and reasonable that the large stockholders should have regard to the interests of the small investors, who perhaps were more in need of pecuniary returns from their holdings, in that while giving them an equality of advantage they provided the means whereby such pecuniary returns would be made to them, not by the corporation itself but by T. Mellon & Sons through the medium of the corporation. * * * In every view of the transaction, we find that its substance is clear. In cases like the present, substance is controlling, and not form. The Court looks through all forms of corporate transactions, and has regard to the substance."

And the Court quotes from the already cited case of *Eisner vs. Macomber*, the following:

> "The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit, on the contrary, every dollar of his original investment, together with whatever accretion and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."
>
> *United States vs. Mellon*, 279 Fed. 910, 914-5.

This decision was affirmed by the Circuit Court of Appeals.

United States vs. Mellon, 281 Fed. 645.

We conclude, therefore, that as to the stock in the new company there was no gain or profit derived from the transaction; that the respondent's interest continued to be exactly the same in the same property after the transaction as before; that as to the stock there was a mere reorganization of The National Acme Manufacturing Company into The National Acme Company from which no gain or profit was "*derived*" by the respondent, and hence there was no taxable income obtained.

Respectfully submitted,

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WEISS, COLLECTOR OF INTERNAL REVENUE, *v.* STEARN.

WEISS, COLLECTOR OF INTERNAL REVENUE, *v.* WHITE.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Nos. 262 and 263. Argued April 30, 1924.—Decided May 26, 1924.

Pursuant to an agreement, the stockholders of an Ohio corporation deposited with a trustee their certificates for all its capital stock ($5,000,000), and other parties deposited $7,500,000; the depositors organized a new Ohio corporation with authorized capital stock of $25,000,000, and powers like those of the old corporation; the new corporation took over the property, assets and business of the old one, assuming its contracts and liabilities, and delivering certificates for all its stock to the trustee, in payment, and carried on the business under the old management; the old corporation was dissolved; the trustee delivered half of the new stock and the whole $7,500,000 to the old stockholders *pro rata*, and the other half of the new stock to the other depositaries; so that each owner of old stock received cash, and also shares of new stock representing an interest in the corporate property and business half as large as he had before. *Held:*

(1) That the new stock received by the old stockholders, unlike the money, was not the proceeds of a sale but represented part of the same capital investment as their old shares, without any segregated gain taxable as income under the Revenue Act of 1916. P. 252.

(2) The transaction amounted to a financial reorganization under which each stockholder retained half his interest and disposed of the remainder. P. 254.

(3) Questions of taxation must be determined by viewing what was actually done rather than the declared purpose of the participants. *Id.*

(4) When applying the Sixteenth Amendment and income tax laws enacted under it, the courts must regard matters of substance and not of mere form. *Id.*

285 Fed. 689, affirmed.

CERTIORARI to judgments of the Circuit Court of Appeals affirming judgments recovered by the respondents in the District Court in their actions to recover money paid under protest as income taxes.

Mr. Alfred A. Wheat, Special Assistant to the Attorney General, with whom *Mr. Solicitor General Beck* was on the brief, for petitioner.

I. The transaction between the respondents and Eastman, Dillon & Company was in fact and legal effect a sale by the respondents of all their stock in the National Acme Manufacturing Company for $300 a share, payable $150 in cash and $150 in securities of another corporation.

The transaction, of course, must be considered in the light of the agreement. That agreement was evidently drawn with care, is free from ambiguity, and expresses clearly a definite intent. The "vendors" agree to and will sell all their shares, and the "purchasers" agree to and will purchase the same from them, as well as any and all shares the holders of which deposit them with the depositary named, for the price of $300 per share, payable one-half in cash and one-half in securities "as hereinafter set forth." The contract was made upon the express condition that it should not become operative unless at least 80 per cent. of the entire outstanding stock should be deposited "for sale." Of course it is apparent that the purpose of Eastman, Dillon & Company, the purchasers, was to become the owners of a half interest in a very profitable business, and we all know that one who holds 50 per cent. of the stock of a corporation practically controls it, where the other half is held by numerous stockholders. The other terms of the agreement show that the purchasers were not buying one-half of the stockholders' stock. They were purchasing the company for the purpose of reorganizing it and placing themselves in control;

so the agreement provides that they shall have an opportunity to investigate the representations made by the vendors with respect to the earnings of the company and the title to the company's property, and, if that examination was unsatisfactory, the purchasers would not be required to carry out the agreement.

The vendors, owning 14,000 shares out of a total issue of 50,000 shares, were to deposit their stock with the depositary, as were all other stockholders who wished to take advantage of the agreement. The stock, as is usual in such transactions, was to be endorsed in blank for transfer, so as to constitute the vendees attorneys in fact and proxies, which would enable them, of course, to vote the stock as it became necessary to transfer the assets to the new company and dissolve the old one. The use of the words "vendors" and "purchasers" throughout the agreement shows that these words were used in no other sense than the usual one of such language in similar agreements. If less than the entire amount of the capital stock of the National Acme Manufacturing Company was deposited, the depositary was to retain ten shares of stock of the new company and $150 in cash on account of each share not deposited until "adjustment for the purchase of such nondeposited stock under the laws of Ohio, or otherwise, can be had." The "purchasers" were to make whatever adjustment might be necessary to acquire such nondeposited stock and to that end might use the shares of stock and money retained by the depositary, and, when the nondeposited stock had been acquired "by the purchasers," the depositary was to turn over to the purchasers any shares or money then remaining in its hands, provided, however, that the vendors, if they desired, should have the right to proceed "in the purchase of such nondeposited stock to the extent and upon the terms which may be deemed equitable" by two gentlemen named, and with the further provision that in lieu of their portion of

the retained stock the purchasers might substitute and deposit such other collateral as might be approved by the two gentlemen. The concluding paragraph of the agreement is also significant, providing for modifications or additions to be made by those gentlemen but denying them power to modify in regard to "prices of the stock sold or time of payment therefor."

II. The excess of both the cash and the value of the National Acme Company's stock, received by the respondents, over the value of the National Acme Manufacturing Company's stock as of March 1, 1913, or, in the case of stock purchased since that date, its cost, was income for the year 1916.

The transaction comes clearly within the language of the act, taxing profits derived from "sales or dealings in property."

The receipt of property may as well constitute income to the taxpayer as the receipt of money. *Peabody* v. *Eisner*, 247 U. S. 347; *Eisner* v. *Macomber*, 252 U. S. 189; *United States* v. *Phellis*, 257 U. S. 156.

Before the transaction, the plaintiffs' stock reflected their original capital investments plus the accretions which had resulted through the old company's business activities and constituted its surplus—a surplus in which they as individual stockholders had no property interest except as it increased the value of their capital. When, however, they sold that stock for its par value and received in addition cash and securities in another corporation, it is clear that they received assets of exchangeable and actual value severed from their capital interests in the old company. *United States* v. *Phellis, supra; Rockefeller* v. *United States*, 257 U. S. 176; *Cullinan* v. *Walker*, 262 U. S. 134; *Eisner* v. *Macomber, supra.* When the exchange had been completed, each stockholder had realized his entire investment and profit in the old company, even though he immediately put part of it into a new venture.

III. The stock received by respondents was, in fact and legal effect, different property from the Company stock which they disposed of.

The ownership by one corporation of the stock of another corporation, or the ownership by the stockholders of one corporation of the stock of another corporation, does not destroy the distinct legal entity of the two corporations. *Pullman's Palace Car Co.* v. *Missouri Pacific Ry. Co.*, 115 U. S. 587; *Peterson* v. *Chicago, etc. Ry. Co.*, 205 U. S. 364.

In cases involving taxation, the courts have consistently refused to disregard the principle of corporate entity. *Eisner* v. *Macomber*, 252 U. S. 189; *Osgood* v. *Tax Commissioner*, 235 Mass. 88; *Stone* v. *Tax Commissioner*, 235 Mass. 93; *United States* v. *Phellis*, 257 U. S. 156.

All the considerations, except that of incorporation under the laws of different States, mentioned by the Court in the *Phellis Case* as supporting the corporate entities of the corporations there in question, are present here. Furthermore, while in the *Phellis Case* the stockholders of the two corporations were identical, in the case at bar the stockholders of the National Acme Manufacturing Company and the National Acme Company were not identical.

Southern Pacific Co. v. *Lowe*, 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71, are clearly distinguishable. See *Peabody* v. *Eisner*, *supra*, p. 349; *Lynch* v. *Hornby*, 247 U. S. 339, 346.

The fact that the respondents acquired no increase in aggregate wealth through the sale or exchange of their stock is not material in determining whether they experienced a realization of profits constituting income. *United States* v. *Phellis*, *supra*, p. 171.

Mr. Charles P. Hine, with whom *Mr. Amos Burt Thompson* was on the brief, for respondent in No. 262.

I. The contract was not for the sale of the stock to Eastman, Dillon & Company at $300 per share, but was for the sale of a half interest at $150, and the substitution for the other half interest of stock in which Eastman, Dillon & Company never had any interest, legal or equitable. The new stock represented a continuation of the same corporate enterprise and the entire equitable interest in the stock which plaintiff received was at all times owned by him.

The fact that one clause of the contract, pursuant to which the exchange of the stock was made, recited that stockholders in the old company agree to sell their stock "for $300 per share, payable one-half in cash and one-half in securities, as hereinafter set forth," did not make the transaction the equivalent of a sale for cash.

The contract was of a dual nature, being in part a contract for the sale of a half interest to Eastman, Dillon & Company, and in part a reorganization agreement between the old stockholders and Eastman, Dillon & Company, providing for the creation by the vendors and purchasers of a new company to stand in the place of the old, and for the distribution by the trustee of the stock of the new company to the old stockholders and to Eastman, Dillon & Company, in proportion to their respective interests, as fixed by the trust agreement. The transaction as carried out resulted in the sale of such half interest and the continuance of the same business.

II. Plaintiff realized no income from the receipt of stock in the National Acme Company, since his capital interest in the same single corporate enterprise continued without any change in the nature of his investment. *Eisner* v. *Macomber*, 252 U. S. 206; *United States* v. *Phellis*, 257 U. S. 156.

III. The same result could have been attained by a process of internal reorganization, and if this manner of procedure had been adopted, no taxable income would have resulted. See *Cullinan* v. *Walker*, 262 U. S. 134, 137.

IV. The mere difference in corporate entity between the National Acme Manufacturing Company and the National Acme Company is not a sufficient basis for holding that income was realized by the exchange of one stock for the other. *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330.

We must assume that it was the purpose of Congress to refrain from taxing as income derived from a transaction the mere increase in capital value of an investment which after such transaction remains in truth and in substance the same investment as before.

After Eastman, Dillon & Company acquired a one-half interest in the stock of the National Acme Manufacturing Company by depositing the cash consideration therefor, they and the other stockholders of the National Acme Manufacturing Company were to unite in forming a new corporation and in causing the old company to transfer its assets to the new. The new company was therefore a mere agency of the stockholders of the old company and subject in all things to their proper direction and control. The principle of *Southern Pacific Co.* v. *Lowe, supra*, is therefore directly applicable. *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71.

In the present case plaintiff merely received different certificates of stock which represented exactly the same proportionate interest in a corporation having the same stockholders, the same assets, powers, purposes and management as the original company.

V. The rule of construction announced in previous decisions prevents a holding that income was realized by the transaction in the case at bar. *Gould* v. *Gould*, 245 U. S. 151.

Mr. John G. White, with whom *Mr. A. V. Cannon* and *Mr. L. C. Spieth* were on the brief, for respondent in No. 263.

Looking through all the forms and machinery, the real transaction is this: The old stockholders sold half their stock to Eastman, Dillon & Company for $7,500,000, and deposited their stock, transferred in blank, with the depositary, subject to this agreement. Thereby Eastman, Dillon & Company became owners of half the stock of the Manufacturing Company and the old stockholders remained the owners of the other half of the stock of the Manufacturing Company. Then the two sets together, thus constituting the whole body of the stockholders of the Manufacturing Company, organized the new company, and the two sets together constituting the whole body of stockholders of the old company as such, through the corporate action agreed to be taken by the agreement, transferred all its assets to the new company for all the stock of the new company and its assumption of all the debts of the old company. The stockholders of the old company having thus become the owners of all the stock of the new company, and it being part of the agreement that this stock shall be divided ratably among the stockholders of the old company, half of this stock went to Eastman, Dillon & Company, or their nominees, they having become the owners of half of the stock of the old company. Half of it, of course, went to the old stockholders of the old company. This being the nature of the transaction, Eastman, Dillon & Company, for their half of the stock of the old company, got half of the stock of the new company or five new shares for one old, and the old stockholders, for each share of the half of the stock of the old company which they owned, after selling the other half to Eastman, Dillon & Company, got five shares of the new company, the new company having exactly the same powers and the same purposes as the old company, and exactly the same assets and the same liabilities. As a consequence, by this part of the transaction there was neither gain nor loss. Each stockholder

simply had a certificate for a larger number of shares than he had before.

There has been no segregation of any of the assets of either the old company or the new company, no stock issued against any part of the assets of the old company or the new company, but the entire assets of the old company, without addition or diminution, which before was the property of all the stockholders of the old company, became the property of all the stockholders of the new company, and represented by all its stock.

Treating it as a sale to Eastman, Dillon & Company of the entire stock for $7,500,000 of cash and $12,500,000 of stock of the new company, the only profit obtained was from the payment of the cash, for half the stock of the new company was of precisely the same value as half the stock of the old company, represented exactly the same assets, the same liabilities, devoted to the same purposes as before, and hence, so far as the old stock was paid for by the new stock, no profit was made, no gain received, and hence no income.

Taking either line of reasoning,—there was no segregation as to the old stockholders of one-half of their stock of any part of the assets, which all still remained in the corporation, devoted to the same uses and purposes as before, subject to corporate control, without any power on the part of the owners of the stock to segregate any part thereof without corporate action. *Eisner* v. *Macomber*, 252 U. S. 189; *Towne* v. *Eisner*, 245 U. S. 418; *United States* v. *Alpha Portland Cement Co.*, 242 Fed. 978; s. c. 257 Fed. 432; 261 Fed. 339; *Peabody* v. *Eisner*, 247 U. S. 347; *Lynch* v. *Hornby*, 247 U. S. 339; *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330; *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71.

Where there are doubts in the construction of a tax law, they should be resolved in favor of the taxpayer and against the Government. *Gould* v. *Gould*, 245 U. S. 151;

Crocker v. *Malley*, 249 U. S. 223. See further *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330; *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71; *United States* v. *Mellon*, 279 Fed. 910; s. c. 281 Fed. 645.

MR. JUSTICE MCREYNOLDS delivered the opinion of the Court.

Respondents brought separate actions to recover money which they alleged petitioner unlawfully demanded of them as income tax. The question for our decision is this: Did they, by the transactions hereinafter detailed, dispose with profit of all or, as they maintain, of only half their interests in the National Acme Manufacturing Company, within the income provisions, Revenue Act of 1916 (c. 463, 39 Stat. 756, 757). Both courts below upheld their claims and gave judgments for appropriate refunds.

Under a definite written agreement the following things were done—

(A) Respondents and other owners delivered duly endorsed certificates representing the entire capital stock ($5,000,000) of the National Acme Manufacturing Company, incorporated under laws of Ohio—the old corporation—to The Cleveland Trust Company, as depositary. Messrs. Eastman, Dillon & Company deposited $7,500,000 with the same Trust Company. Representatives of both classes of depositors thereupon incorporated in Ohio the National Acme Company—the new corporation—with $25,000,000 authorized capital stock and powers similar to those of the old corporation. Pursuing the definite purpose for which it was organized, the new corporation purchased and took over the entire property, assets and business of the old one, assuming all outstanding contracts and liabilities, and in payment therefor issued to the Trust Company its entire authorized capital stock. It continued to operate the acquired business under the former management, and the old corporation was dissolved.

(B) The Trust Company delivered to Eastman, Dillon & Company certificates for half the new stock—$12,500,000. To the owners of the old stock—to each his pro rata part—it delivered certificates representing the remaining half, together with the $7,500,000 cash received from Eastman, Dillon & Company. The owner of each $100 of old stock thus received $150 cash, also $250 of new stock representing an interest in the property and business half as large as he had before. Prior to the specified transactions his interest in the enterprise was 100/5,000,000; thereafter it became 250/25,000,000, or 50/5,000,000.

The Collector ruled that each old stockholder sold his entire holding, and assessed respondent accordingly for resulting profits. Adopting a different view, the courts below held that he really sold half for cash and exchanged the remainder, without gain, for the same proportionate interest in the transferred corporate assets and business.

We agree with the conclusion reached below. The practical result of the things done was, a transfer of the old assets and business, without increase or diminution or material change of general purpose, to the new corporation; a disposal for cash by each stockholder of half his interest therein; and an exchange of the remainder for new stock representing the same proportionate interest in the enterprise. Without doubt every stockholder became liable for the tax upon any profits which he actually realized by receiving the cash payment. If by selling the remainder he hereafter receives a segregated profit, that also will be subject to taxation.

Petitioner relies upon *United States* v. *Phellis*, 257 U. S. 156, and *Rockefeller* v. *United States*, *id.* 176; also *Cullinan* v. *Walker*, 262 U. S. 134, which followed them. As the result of transactions disclosed in the *Phellis* and *Rockefeller Cases*, certain corporate assets not exceeding accumulated surplus were segregated and passed to individual stockholders. The value of the segregated thing

so received was held to constitute taxable income. Cullinan's gain resulted from a dividend in liquidation actually distributed in the stock of a holding company incorporated under the laws of a foreign State, not organized for the purpose of carrying on the old business, and which held no title to the original assets.

Eisner v. *Macomber,* 252 U. S. 189, gave great consideration to the nature of income and stock dividends. It pointed out that, within the meaning of the Sixteenth Amendment, income from capital is gain severed therefrom and received by the taxpayer for his separate use; that the interest of the stockholder is a capital one and stock certificates but evidence of it; that for purposes of taxation where a stock dividend is declared, the essential and controlling fact is that the recipient receives nothing out of the company's assets for his separate use and benefit. The conclusion was that, " having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."

Applying the general principles of *Eisner* v. *Macomber,* it seems clear that if the National Acme Manufacturing Company had increased its capital stock to $25,000,000 and then declared a stock dividend of four hundred per cent., the stockholders would have received no gain—their proportionate interest would have remained the same as before. If upon the transfer of its entire property and business for the purpose of reorganization and future conduct the old corporation had actually received the entire issue of new stock and had then distributed this pro rata among its stockholders, their ultimate rights in the enterprise would have continued substantially as before—the capital assets would have remained unimpaired and nothing would have gone therefrom to any stockholder for his separate benefit. The value of his holdings would not have changed, and he would have retained the same essential rights in respect of the assets.

We can not conclude that mere change for purposes of reorganization in the technical ownership of an enterprise, under circumstances like those here disclosed, followed by issuance of new certificates, constitutes gain separated from the original capital interest. Something more is necessary—something which gives the stockholder a thing really different from what he theretofore had. *Towne* v. *Eisner*, 245 U. S. 418; *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330; *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71. The sale of part of the new stock and distribution of the proceeds did not affect the nature of the unsold portion; when distributed this did not in truth represent any gain.

Considering the entire arrangement we think it amounted to a financial reorganization under which each old stockholder retained half of his interest and disposed of the remainder. Questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants; and when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of substance and not mere form.

Affirmed.

MR. JUSTICE HOLMES and MR. JUSTICE BRANDEIS dissent on the ground that the case falls within the rule declared in *Cullinan* v. *Walker*, 262 U. S. 134.